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Private Ordering Within Partnerships

Robert W. Hillman

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Private Ordering Within Partnerships*

ROBERT W. HILLMAN**

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I. INTRODUCTION

Partnership law has developed little, if at all, since the adoption of the Uniform Partnership Act (U.P.A.)¹ nearly seventy-five years ago. When a body of law stagnates, legal scholars typically lead the charge for reform. Yet this has not happened with partnership law, which seems to have assumed something of a "sacred cow" status in the academic community.

There is now a "window of opportunity" for meaningful reform of partnership law. Recently, the National Conference of Commissioners on Uniform State Laws authorized a revision of the U.P.A.² Work on this project should begin in the middle of 1987 and is likely to last several years. Although the revision represents an excellent opportunity for diverse scholarly commentary and influence, the past practice of most scholars in the field of business association to neglect or subordinate issues affecting partners suggests the probability of only limited participation by academics in this re-evaluation of long-standing principles of partnership law.

The reverence accorded partnership law is not the product of careful scrutiny. We need only look at the treatment of partnerships in law school curricula to determine why so many students believe, incorrectly, that the source of all meaningful rules governing partners is the Internal Revenue Code. Introductory courses in business associations often emphasize corporations and minimize or avoid altogether treatment of partnership law.³ Law review articles on

1. UNIF. PARTNERSHIP ACT (1969).

2. This action is not the product of widespread demands for a revision of the U.P.A. Instead, it was prompted by the work of a Subcommittee of the Partnership Committee of the American Bar Association's Section on Corporation, Banking, and Business Law. The Subcommittee, which was chaired by Professor Harry J. Haynsworth, reversed the traditional reluctance of the Bar to upset established principles of partnership law. In the spring of 1986, the Subcommittee produced a comprehensive and very useful report. See U.P.A. REVISION SUBCOMMITTEE OF THE ABA PARTNERSHIP COMMITTEE, CORPORATE BANKING AND BUSINESS LAW SECTION, *Should the Uniform Partnership Act be Revised?* [hereinafter U.P.A. REVISION SUBCOMMITTEE REPORT].

3.

It is strange that decades marked by a proclaimed interest in the legal problems of the individual and the disadvantaged would have witnessed a near total abandonment of formal study of the business vehicles [agency and partnership] most generally encountered by the average citizen. Even schools that nominally retained business organizations or business associations courses seem to assume

problems affecting partners are scarce;⁴ pages devoted to "business topics" are assigned to more glamorous issues such as insider trading, greenmail, hostile takeovers, and the fiduciary responsibilities of directors. It is as if partners did not exist.

If partnership law were simply ignored, the neglect would affect only the several million individuals who conduct their businesses under this form of organization.⁵ The harm is not limited to partners, however, for a recurring theme in the literature concerning close corporations is that various aspects of partnership law, and in particular the freedom it accords partners to alter statutory norms by agreement, may provide suitable models for reform of corporate law.⁶ Although the analogy between the needs of participants in close cor-

that the problems of the publicly held corporation . . . should monopolize the attention of the classroom.

D. FESSLER, *ALTERNATIVES TO INCORPORATION FOR PERSONS IN QUEST OF PROFIT* at XIX (1986).

This problem is reflected in many casebooks. Fortunately, there are course materials treating partnerships in some depth. *See, e.g.*, A. CONARD, R. KNAUSS, & S. SIEGEL, *ENTERPRISE ORGANIZATION* (1972); D. FESSLER, *supra*; R. HAMILTON, *CORPORATIONS, INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS* (1986); H. HENN, *AGENCY-PARTNERSHIP* (1985); L. RIBSTEIN, *BUSINESS ASSOCIATIONS* (1983).

4. One of the more competent law review treatments of partnership law may be found in Ribstein, *An Analysis of Georgia's New Partnership Law*, 36 *MERCER L. REV.* 443 (1985). Georgia was the last state to adopt the Uniform Partnership Act.

5. Reliable and precise data on partnerships are difficult to obtain. Some evidence of the popularity of this form of business organization may be gleaned from information compiled by the Internal Revenue Service. Unfortunately, the information concerning partnerships does not distinguish among general partnerships, limited partnerships, and other unincorporated business associations. Using this expanded definition, there were nearly ten million partnerships as of 1982. *See* Internal Revenue Service, *Selected Statistical Series 1970-85*, 4 *STATISTICS OF INCOME BULL.*, 82 (Table 5) (Spring 1985).

6. *See, e.g.*, Bradley, *Toward a More Perfect Close Corporation—The Need for More and Improved Legislation*, 54 *GEO. L. J.* 1145, 1148 (1966) ("Associates in a close corporation wish to assume partnership characteristics . . ."); Cary, *How Illinois Corporations May Enjoy Partnership Advantages: Planning for the Closely Held Firm*, 48 *NW. U.L. REV.* 427, 427 (1953) (recognizing recent emphasis on the question of "how a business, once incorporated, can nonetheless enjoy partnership advantages"); Hetherington & Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 *VA. L. REV.* 1, 2 (1977) (The close corporation is the "functional equivalent" of a partnership.); Hornstein, *Stockholders Agreements in the Closely Held Corporation*, 59 *YALE L.J.* 1040, 1040 (1951) (Stockholders in close corporations "generally prefer certain of the attributes of partnership, particularly with respect to control and dissolution."); Israels, *The Close Corporation and the Law*, 33 *CORNELL L.Q.* 488, 488 (1948) ("[T]he participants [in a close corporation] consider themselves 'partners' and seek to conduct the corporate affairs to a greater or lesser extent in the manner of a partnership."); *id.* at 491 (The "objective of the participants in a close corporation is to equate the scheme of governance of their enterprise to that of a partnership."); O'Neal, *Preventive Law: Tailoring the Corporate Form of Business to Ensure Fair Treatment of All*, 49 *MISS. L.J.* 529, 533 (1978) ("Businessmen forming a close corporation frequently consider themselves partners; they incorporate only to obtain limited liability or other corporate advantages.").

porations and partnerships is apt, partnership law requires much closer study than it has received to date to determine whether the legal principles under which partners operate would prove better subjects than models for reform.⁷

What accounts for the neglect and sacred cow status of partnership law and why are partners less deserving of attention than shareholders, directors, or parties to simple, discrete contracts? Several explanations may be offered. The most obvious is that all problems of partnership law have been solved. If nothing else, partnerships and the law affecting these ventures have survived the tests of time and geography. The partnership is probably the oldest form of business organization.⁸ The U.P.A., which both codified and reformed the common law of partnerships,⁹ has been adopted in forty-nine states;¹⁰ further, its principles are reflected in varying degrees in the legal regimes of such diverse jurisdictions as England, France, and Ger-

7. The staleness of partnership law is in marked contrast to the more dynamic reforms affecting participants in closely held corporations. Although much remains to be done, the momentum for reform has clearly been established. For an interesting empirical study of the attitudes of attorneys and legislators towards close corporation legislation, see Empirical Research Project, *Statutory Needs of Close Corporations—An Empirical Study: Special Close Corporation Legislation or Flexible General Corporation Law?*, 10 J. CORP. L. 849 (1985).

When partnership law is compared to the state of the pre-reform law applicable to close corporations, there is little question that partnership law represented a relatively more advanced and sensible regime for regulating a small business venture. Partnership law fares less well when compared with more modern close corporation statutes and decisions reflecting an understanding of the special problems faced by closely held business enterprises.

In one respect, however, conclusions concerning the relative advancement of the two related areas of the law should be tempered. Partnership law, unlike corporate law, must cover the large number of informal, casual, or even accidental relationships between co-participants in an "intimate" business venture. The formalities needed to form a corporation, which generally require the use of legal counsel, may result in more sophisticated planning and the development of a degree of consensus that possibly will minimize future disputes between the participants. The partnership form of organization, on the other hand, is a catch-all that must embrace both well planned and carelessly established business associations. Inevitably, partnership law, at least when applied to the latter, will of necessity appear in a more "primitive" state than corporate law.

8. One commentator has observed:

Partnership—using the term in a general way—must be as old as cooperative activity. Indeed, it has obvious origins in family and clan activity of the most ancient and rudimentary sort. As a profit sharing arrangement it has traceable course from Babylonian share-cropping through classical Greece and Rome to the far-flung trading enterprises of the Renaissance.

A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 2 (1968).

9. See *id.* at 13 (noting that "[c]ourts and lawyers are fond of saying that the U.P.A. merely codifies the common law. . . . In many respects, depending on a jurisdiction's version of the common law, the Act does merely codify. But in many others, particularly those centering on property and creditor's rights, it makes major changes").

10. Louisiana is the only state not to adopt the U.P.A. A number of adopting states, however, have modified the U.P.A. Generally, the states have made only minor modifications.

many.¹¹ When legal principles have been accepted in so many jurisdictions and for such a long period of time, there is an understandable tendency to treat them as revealed natural law.

This is simply wrong. Apart from numerous technical deficiencies in the U.P.A.,¹² partnership law has not been tested against the conditions under which partnerships today operate.¹³ Very little is known about partnerships and their members. We have, for example, little understanding of how these unincorporated ventures actually operate. How many partnerships are formed without written agreements? What do partners assume concerning the norms that will govern their conduct? Do partners regard themselves as fiduciaries? What types of bargaining activities occur when the parties do not focus their attention on development of a written partnership agreement? Is bargaining an activity that takes place continuously throughout the life of a partnership? How important are non-economic interests, such as status and self-esteem, to partners? How egalitarian are partnerships? How and why are most partnerships brought to an end? What are the types of disputes that occur regularly, but are not litigated? How many partners can afford to litigate disputes? Is dissolution often an abusive act designed to squeeze out unwanted partners?

Perhaps the very age of partnership law may render it an unattractive topic of study. Unquestionably, partnership law has a long heritage; less politely, some might say it is antiquated. Unlike the dynamic and well-publicized problems affecting publicly-held corporations, issues of partnership law may appear stale, and therefore, dull. Many scholars may fail to see the attraction of a seemingly unalterable and aged body of law.

Any assumed staleness is aggravated by the facts that partnerships often are informally organized,¹⁴ carelessly managed, less than prosperous, and, when viewed individually, relatively inconsequential

11. See, e.g., English Partnership Act, 1890 53 & 54 Vict., ch. 39, § 24(8); E. Scamel, LINDLEY ON THE LAW OF PARTNERSHIP (1971); H. DeVRIES, N. GALSTON, & R. LOENING, MATERIALS FOR THE FRENCH LEGAL SYSTEM (3rd ed. 1979); THE GERMAN COMMERCIAL CODE (S. Goren & I. Forrester trans. 1979). See generally 13 J. HEENEY, INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 1 (A. Conrad ed. 1985).

12. Those technical deficiencies will not be discussed in this article. If an example is desired, however, one need only look at the inconsistent and confusing terminology contained in section 38 of the U.P.A.

13. Reported litigation does little to develop or refine partnership law principles. This is particularly true of standards affecting the fiduciary responsibilities of partners. See *infra* text accompanying notes 109-64.

14. The only prerequisite to partnership status is that there be "an association of two or more persons to carry on as co-owners a business for profit." UNIF. PARTNERSHIP ACT, § 6(1). Sometimes, partnerships are created accidentally. See Hillman, *The Dissatisfied*

in economic effect. Stated bluntly, partnerships are messy and therefore unattractive subjects for study. They are, however, worthy of attention, if not because of the important consequences they carry for the multitude of individuals who choose to carry on ventures under this most casual form of organization,¹⁵ then because collectively they represent a significant economic force.¹⁶

The absence of an organized bar advancing the interests of members of general partnerships has undoubtedly contributed to the lifelessness of "modern" partnership law. It is interesting in this regard to compare the profession's relative lack of interest in general partnerships with the extensive activities undertaken in support of reform of the law applicable to limited partnerships,¹⁷ which generally are larger and use extensively the services of lawyers. Similarly, a small but cohesive segment of the profession has prospered in providing tax services for partnerships, both limited and general. Most general partners, however, are not significant consumers of legal services. Unless and until they incorporate, attempt a public syndication, or develop sufficient income to generate tax problems, partners constitute a large constituency without vigorous representatives in the bar.¹⁸

Yet another possible explanation for the sacred cow status of this field is that as an academic discipline, partnership law is an orphan of recognized fields of scholarship. The issues of corporate law have appeared far more pressing and rewarding to those scholars interested in business associations, and contract law scholars have shown little inclination to treat partnerships as a subject of study within their discipline. Partnership law is neither fish nor fowl in the community of legal scholars, and because it does not fall clearly within a defined academic discipline or popular course description, this body of law has drifted without direction.

The orphan status of this body of law is paradoxical. It should be apparent (but for some reason is not) that partnership law offers tremendous opportunities for the application and refinement of newer

Participant in the Solvent Business Venture: A Consideration of the Relative Permanency of Partnerships and Close Corporations, 67 MINN. L. REV. 1, 17 n.53 (1982).

15. "The demise of agency and partnership in the law school curriculum did not abolish recurrent client problems in this important area—it merely produced a generation of inadequately trained lawyers." D. FESSLER, *supra* note 3, at xix (emphasis in original).

16. As of 1982, partnerships' payrolls and receipts exceeded \$30 billion and \$250 billion, respectively. See Internal Revenue Service, *supra* note 5, at 82. For a discussion of the limitations of this data, see *supra* note 5.

17. Developed in 1916, the Uniform Limited Partnership Act was revised in 1976 and 1985. Limited partnerships are beyond the scope of this article.

18. The work of Professor Haynsworth and his Subcommittee provide a commendable exception to the bar's characteristic neglect of partnership law. See *supra* note 2.

modes of evaluating legal rules. For example, we have little understanding of the economic efficiency of partnership law. Developed long before the application of economics-based analysis, the U.P.A., unlike many aspects of corporate law, has largely escaped the attention of those inclined to evaluate legal principles under standards emphasizing the efficient allocation of resources.¹⁹ This is inexplicable, for partnership law would seem to be ideally suited for analysis under efficiency criteria.²⁰

Partnership law should also prove of interest to scholars of contract law interested in private governance and continuing relationships. The partnership contract is different from the normal, discrete contract between unaffiliated parties. Partnerships may have an extended life during which conditions applicable to the conduct of the business change dramatically. Some more modern contracts scholars have advanced a "relational" theory of contract obligation applicable to long-term relationships established by agreement.²¹ These discussions, however, have typically treated partnerships in only a limited and passing way. The isolation of partnership law from one of the more intriguing and promising theories of contract law has unquestionably retarded its development.

The chronicle of explanations for both the neglect and the sacred cow status of partnership law could continue indefinitely. One additional reason, however, is worthy of emphasis. "Freedom to bargain" is an enormously popular norm advanced by scholars in diverse areas of the law. Partnership law seems to reflect this premise, for the U.P.A. subordinates many of its more important provisions to contrary agreements between partners. If the law of partnerships is found in the agreements of partners, the case for "law reform" would be tenuous. There is thus an appeal to the premise that bargaining

19. Close corporations also have been neglected in this regard. See Easterbrook & Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986).

20. There is a growing body of literature on the much more general subject of agencies. Some insights concerning partnerships may be extrapolated from this material, although for the most part partnerships receive little or no attention. See, e.g., PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS (J. Pratt & R. Zeckhauser eds. 1985); Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

21. See, e.g., Gillette, *Commercial Rationality and the Duty to Adjust Long-Term Contracts*, 69 MINN. L. REV. 521 (1985); Goetz & Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981); MacNeil, *Values in Contracts: Internal and External*, 78 NW. U. L. REV. 340 (1983); MacNeil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 NW. U.L. REV. 854 (1978) [hereinafter MacNeil, *Adjustment*]; MacNeil, *The Many Futures of Contract*, 47 S. CAL. L. REV. 691 (1974).

should be encouraged and a corresponding conclusion that partnership law does exactly what it should do in promoting contractual relations. Upon closer examination this conclusion, however attractive its premise, may prove unfounded.

The purpose of this article is to explore bargaining as a means of private ordering within partnerships. Do partners bargain? When do partners bargain? What factors, statutory or otherwise, impede bargaining? Are bargains between partners truly enforceable? How and why are bargains broken? Does the U.P.A. provide adequate norms to serve as bargain-substitutes? What is the relationship between bargaining and the status of partners as fiduciaries? What purposes are served by treating partners as fiduciaries? Can either bargaining or fiduciary responsibilities regulate the quest for private advantage within partnerships? Resolution of these issues is problematic, and this article will not offer a detailed "blueprint" for reform. It will, however, evaluate limitations on bargaining, the nature of bargaining that occurs in partnerships, widespread misperceptions about bargaining, and aspects of the U.P.A. that facilitate and retard bargaining.

As a point of reference, the analysis will frequently discuss the classic "model" partnership for which existing partnership law seems most suited. This is a small, intimate venture organized along egalitarian lines. The partners are active in their business, and they share responsibilities and profits equally. Undoubtedly, this describes many, and perhaps most, partnerships. Not all partnerships, however, fit this egalitarian norm. Some small partnerships, for example, assume decidedly nonegalitarian characteristics as one partner assumes dominance and other partners are relegated to a status closely approximating that of employees. Other partnerships, such as multi-city corporate law firms, are simply too large to operate on an egalitarian basis. Although these more hierarchical organizations bear little resemblance to the model egalitarian venture upon which much of our thinking concerning partnerships is based, they are nevertheless "partnerships" structured, in theory, through bargaining. The very diversity of partnerships renders the study of both partnership law and private ordering within partnership most challenging.

II. AGREEMENTS, BARGAINING, AND RE-BARGAINING

The most distinctive characteristic of partnership law is the freedom it gives partners to structure their affairs by agreement. The most common misperception of partnership law is that partnership agreements, as popularly perceived, provide the primary means of private ordering within partnerships.

A. *Agreements and the U.P.A.*

Deference to agreements is a recurring theme of the U.P.A., which expressly subordinates many of its more important provisions to contrary agreements between partners.²² With some justification, scholars of close corporation law often look with envy on this feature of the U.P.A.,²³ and recent reforms of corporate law clearly show the influence of partnership law's deference to agreements.²⁴

When compared to the alternative of rigid statutory rules for business governance, deference to agreements provides a sensible starting point for ordering within partnerships. Ideally, partners know what they want and are prepared to bargain with each other for the purpose of structuring a relationship that will yield maximum collective and individual benefits. In principle, the product of this bargaining is a partnership agreement binding each participant to the deal that has been struck.

The reality, however, may be quite different. For a variety of reasons, some good and others not, partners often commence their ventures with a handshake rather than by formalizing their understandings in partnership agreements. These partnerships will thereafter operate under the "default" norms²⁵ provided by the U.P.A. Even when agreements are developed and bear all the trappings of binding, unbending, and complete legal documents, partners may renegotiate past agreements when they possess bargaining leverage to use against their co-partners. Indeed, in many important respects, the U.P.A. deprecates the "first" agreement and provides conditions for continuous bargaining throughout the lives of partnerships.

B. *Obstacles to the Development of Definitive Agreements*

If asked to define what constitutes a "partnership agreement," most law students and legal professionals would describe a formal and

22. See, e.g., UNIF. PARTNERSHIP ACT § 8 (Partnership Property); § 9 (Partner Agent of Partnership as to Partnership Business); § 18 (Rules Determining Rights and Duties of Partners); § 27 (Assignment of Partner's Interest); § 37 (Right to Wind Up); § 38 (Rights of Partners to Application of Partnership Property); § 40 (Rules for Distribution); § 42 (Rights of Retiring Partner or Estate of Deceased Partner When the Business is Continued); and § 43 (Accrual of Actions).

23. See *supra* note 6.

24. See, e.g., Committee on Corporate Laws, *Proposed Statutory Close Corporation Supplement to the Model Business Corporation Act*, 37 BUS. LAW. 269 (1981). The American Bar Association's Committee on Corporate Laws adopted the proposals in 1982. Committee on Corporate Laws, *Statutory Close Corporation Supplement to the Model Business Corporation Act*, 38 BUS. LAW. 1031 (1983).

25. See *supra* note 22. The norms are termed "default" because they are effective only when partners have not reached contrary agreements.

usually lengthy document negotiated and executed at the inception of a partnership. Under this inaugural view of partnership agreements, the governance of partnerships occurs with reference to the product of the consensus manifested but once.

Accepting only for the moment this view of partnership agreements, a number of factors may limit the ability of partners to establish an agreement adequate to regulate their relationship in the future. Some of these limitations arise from conditions external to the agreement, including both the unwillingness of many partners to articulate and formalize their understandings and various provisions of the U.P.A. undermining the effects of prior bargains. Other limitations are inherent in the agreements themselves.

1. INFORMALITY

Partnership agreements in the form of written, definitive statements of the relative rights and duties of partners are unknown to many partners. A large number of partnerships, perhaps a majority, are created informally.²⁶ Lawyers are not consulted. Written documents are not prepared. Establishment of the relationship is a non-event.

The ease of forming a partnership may undermine effective bargaining. Because of the unwillingness or inability of partners to avail themselves of bargaining opportunities, the occasion for the development of consensus through an agreement often is not present. Accordingly, the great freedom accorded partners to alter statutory norms by agreement may be of little benefit to a large number of partners whose ventures are best described, at least initially, as partnerships without bargains.²⁷

2. MISGUIDED OPTIMISM

Acting in concert with informality to inhibit bargaining and the development of an agreement is the "bliss" so often characteristic of participants about to wed in a closely held venture. At the inception of a business relationship, the possibility of anything other than prosperity and happiness may seem remote to those pooling their resources in a commercial marriage.²⁸ Because of this, the very act of

26. Unlike a corporation, a partnership may be formed without adherence to any formalities. *See supra* note 14.

27. Oral agreements, however, are common; for obvious reasons, such understandings cover a relatively limited number of issues. If proven, they are generally enforceable. For a discussion of the applicability of the statute of frauds, see A. BROMBERG, *supra* note 8, § 23.

28. "Since a partnership is an extremely intimate relationship, perhaps the greatest potential problem is the risk of future disagreement among those who start out with the

bargaining over matters that may suggest a divergence of interests may appear antithetical to the harmony and trust existing in the early stages of a jointly-owned business.²⁹ It is only in retrospect that the eventual disintegration of a partnership was foreseeable.

3. LONG TERM AGREEMENTS AND THE FUTURE

Assuming partners engage in serious bargaining, a further problem relevant to both partnerships and close corporations is that there is only so much that an agreement can accomplish. An agreement may establish, for example, the relative interests and duties of the participants, the term of the venture, and the consequences of a dissolution. These issues are not difficult to isolate and can be anticipated and addressed through bargaining. But business governance is far more dynamic than a limited list of bargaining issues would suggest.³⁰ Individuals establishing a venture make certain assumptions concerning the subsequent course of their business and the relationships likely to be developed between the participants. In so doing, they view the future largely from the perspective of the present. Although the better partnership agreements attempt to anticipate change, the degree to which any agreement reflecting a bargain at a defined point in time can do this is open to question.

4. LEGAL ACTORS AS INHIBITORS OF BARGAINING

Assuming legal counsel is retained, a number of factors limit the effectiveness of an attorney in facilitating bargaining between partners. One is the understandable tendency of partners in smaller ventures to employ only one attorney to document their understandings. This reflects both a desire to control costs and a general aversion towards the legal profession. Although accepted standards of professional conduct may tolerate such arrangements,³¹ and use of a single

highest mutual regard." Worcester, *The Drafting of Partnership Agreements*, 63 HARV. L. REV. 985, 986 (1950).

29. See Note, *Mandatory Arbitration as a Remedy for Intra-Close Corporate Disputes*, 56 VA. L. REV. 271, 276 (1970) ("Planning for irreconcilable disagreement may itself strain the mutual trust upon which the business collaboration is founded."). For an account of a lawyer advising business partners against having a formal agreement, see Hetherington, *Special Characteristics, Problems, and Needs of the Close Corporation*, 1969 U. ILL. L.F. 1, 17 n.65; see also W. KLEIN & J. COFFEE, *BUSINESS ORGANIZATION AND FINANCE* 61-63 (1986).

30. See Hillman, *Indissoluble Partnerships*, 37 U. FLA. L. REV. 691 (1985).

31. Rule 1.7 of the Model Rules of Professional Conduct, for example, requires client consent if "representation of [a] client will be directly adverse to another client". The comment, however, reflects a rather accommodating approach: "A lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation is permissible where the clients are generally aligned in interest

lawyer may reduce the friction that is so often the by-product of bargaining between lawyers, the interests of partners will in a number of respects diverge rather than converge. The combined role of mediator and bargain-facilitator is one for which many lawyers are not well suited.³²

A related problem concerns the function lawyers are to perform in assisting individuals about to launch a partnership. More precisely, are lawyers expected to be participants in the process of molding the relationships of their clients, or are they assigned the more limited role of documenting the bargaining efforts of others? And, more importantly, who makes the determination of the role to be performed by lawyers? To a large extent, the answers depend on the size of the venture, the sophistication of the clients, the experience of the lawyers, and the involvement of other professionals, such as investment bankers and accountants.³³

Our immediate concern is general partnerships. Typically, these ventures are not of a size to justify employment of more than one lawyer; use of individuals from other professions is out of the question.³⁴ In some cases, the partners are more sophisticated than their attorneys, a condition that normally limits the "legal" function to one of documentation. In other cases, however, the partners may rely upon their lawyer to advise them on matters not traditionally regarded as legal in nature. And for those lawyers with general practices and limited experience in business problems, this may prove difficult.

How do lawyers gain sophistication in business matters? Many do, although law schools can certainly claim no credit for the achievement.³⁵ Normally, sophistication is the product of post-law school specialization and experience. The benefit of the resulting sophistication is available only to those willing to pay the premium charged for specialized legal services. However cost-effective this purchase may be, many partners about to embark on their comparatively small-scaled ventures will turn to seemingly less expensive and less exper-

even though there is some difference of interest among them." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 comment (1983).

32. Lawyers are aware that their involvement in the planning process may itself be a cause of friction between partners. See W. KLEIN & J. COFFEE, *supra* note 29, at 63-65.

33. For an excellent discussion of these and related questions, see Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984). For the most part, the clients of the lawyers Professor Gilson studied are larger entities better able to afford costly legal services than the "typical" partner discussed in this portion of the article.

34. This is, however, with the possible exception of accountants.

35. I am in complete agreement with the observations of Professor Gilson in this regard. See Gilson, *supra* note 33, at 303-06.

perienced general practitioners for needed legal services.³⁶ This decision is reinforced by the attitudes of larger law firms, which for reasons of economics and prestige see little advantage in including small partnerships in their client bases.

Further, the documentation function traditionally performed by the lawyer may retard rather than promote bargaining. Again, considerations of expense, efficient use of a lawyer's time, and breadth of business background may preclude the attorney from tailoring the agreement to the needs of the parties.³⁷ Form books, scissors, and paste lower costs, but at the expense of negating actual bargaining between partners.³⁸ For this reason, a tailored and comprehensive agreement may prove an elusive goal for most partnerships.³⁹ Whether that goal is even worthy of pursuit, however, depends in part upon the adequacy of traditional drafting approaches in responding to the needs of many partners.

Agreements drafted by lawyers tend to be quite specific. Many disputes between partners, however, do not fall within the precise terms of even "definitive" agreements. A very large amount of litigation between partners is resolved on a basis other than prior agreements between the partners. Claims based on breaches of fiduciary duties, for example, do not normally rest upon violations of written agreements, but rather are grounded more generally in broad assertions that certain actions violate the standard of "good faith" expected of partners.⁴⁰ No matter how complete the agreement, it will leave open a vast range of matters that may be the subject of future disputes.

36. Admittedly, the observations offered in this paragraph are very generalized, and exceptions should be noted. In particular, a number of attorneys practicing alone or in small firms have developed specialized practices, are very sophisticated in business matters, and provide cost-effective legal services for their clients. This is in contrast to the larger number of attorneys with more general practices and comparatively little business law experience.

37. See *supra* note 15.

38. Commentators have recently suggested that lawyers may exercise greater care in preparing partnership agreements than corporate documents, which may be perceived as routine. See W. KLEIN & J. COFFEE, *supra* note 29, at 65-66. They acknowledge, however, that this observation is based upon "casual empiricism." Given the inadequate training most lawyers have received in partnership law, it is unclear how, on a cost-effective basis, they can produce adequate partnership agreements. On the basis of my own "casual empiricism," I disagree with Professors Klein and Coffee and believe that standard forms dominate "creative" thought in the drafting of partnership agreements, particularly when considerations of cost are important.

39. Cf. Fessler, *The Fate of Closely Held Business Associations: The Debatable Wisdom of "Incorporation"*, 13 U.C. DAVIS L. REV. 473, 483-84 n.22 (1980) ("Perhaps it is appropriate that the lack of considered reasoning that is often behind the decision to incorporate can now be matched by an absence of particularized drafting in the crucial process of incorporation.").

40. See *infra* text accompanying notes 119-64.

A definitive agreement may not only prove incomplete, but also may be poorly understood by the partners for whom it has been prepared. The term "legalisms," although pejorative, may aptly describe the work product of many attorneys called upon to prepare partnership agreements. Whether partners actually read these documents is open to question. Whether they understand them is even more problematic. We can dismiss this as the failings of the partners themselves, although the large number of partners who gain their first real understanding of their agreements only upon litigation may have strong contrary opinions on the matter.

This raises the issue of whether radically different approaches should be developed for the drafting of *some* partnership agreements.⁴¹ Typically, a lawyer asked to draft a contract of any variety will produce a lengthy and complex document purporting to state the mutual rights and obligations of the parties. The attorney who adopts a nonconventional approach proceeds at her peril. However comforting to lawyers, these documents may appear to partners to be irrelevant to the deals they have struck. This may in part explain the aversion displayed by many partners to the use of attorneys.

Courageous and innovative attorneys might consider a different approach to the drafting of partnership agreements for those who might otherwise avoid the use of legal counsel.⁴² Consider, for example, the potential bargaining stimulus prompted by a one page partnership agreement. This brief document, unknown to most American lawyers, might begin with a brief statement of the expectations of each participant and follow with an equally concise list of the principal terms under which they will operate.⁴³ The development of such an agreement may facilitate bargaining far more effectively than delegation of the drafting function to a disinterested third party. The attorney would then assume the role of educator, a task for which he, at least theoretically,⁴⁴ is well suited.⁴⁵

41. The traditional approach may remain most suitable for those partnerships with substantial resources and populated by sophisticated partners. In these types of ventures, the substantial costs in bargaining may be justified.

42. In particular, the alternative approaches work best for small partnerships.

43. With proper coaching, some partners could write their own agreements.

44. Once again, the problem becomes one of adequately educating attorneys and law students.

45. More cautious but still innovative attorneys may bifurcate the contract. One document would be the typical, lengthy partnership agreement. The second document would be a concise Statement of Mutual Expectations. In many cases, this latter document would serve to focus the partners' attention on the major "deal points" and the reasons for the commitment of each participant. The Statement of Mutual Expectations is related to but distinguishable from the more traditional letter of intent. Unlike the typical letter of intent, the Statement would constitute a "binding" document that may significantly affect the

If the use in some situations of a partnership agreement as a simple, constitutional document⁴⁶ has merit, then yet another alternative should be considered. California has developed statutory will forms largely in response to the reluctance of many individuals to use traditional legal services.⁴⁷ Partners without agreement are, in a sense, intestate, and the development of a simple, statutory partnership agreement may be an appropriate response to the unwillingness or inability of many partners to pay for more customized legal services.⁴⁸ Such a form could consist of a checklist easily reviewed by partners and completed with the assistance of an attorney. Costs would be reduced, and the options presented on the statutory form would focus the attention of partners on the principal issues affecting their relationships. Obviously, some partners would require customized partnership agreements prepared along more traditional lines, but a simple statutory form would facilitate bargaining and agreements by many partners who otherwise would establish their relationships more casually.

If we wish partners to bargain then it is necessary for the legal profession to develop mechanisms and services to facilitate that process.⁴⁹ In evaluating the reasons many partners decline bargaining opportunities, aversion to the form and costs of traditional legal services should not be overlooked.

5. DISSOLUTION AS A MEANS OF AVOIDING PRIOR BARGAINS

One of the most curious features of the U.P.A. is that it renders all partnerships freely dissolvable.⁵⁰ Strangely, the reverence accorded agreements by partnership law does not extend to agree-

resolution of future disputes. For example, the Statement may provide a basis for a judicial decree of dissolution under the "equitable" circumstances standard of section 32 of the U.P.A.

46. Cf. MacNeil, *Adjustment*, *supra* note 21, at 894 ("I feel some temptation to think of the written parts of contractual relations, especially very formal parts, such as collective bargaining agreements and corporate charters and bylaws, as constitutions. . . . [But] [i]f that concept or terminology is used to resurrect 'constitutions' long decayed and made obsolete, . . . we are, as a matter of principle, back to a relationally dysfunctional neoclassicism.").

47. See CAL. PROB. CODE § 6240 (West 1986).

48. Cf. Note, *The Statutory Will: A Simple Alternative to Intestacy*, 35 CASE W. RES. L. REV. 307 (1984) (noting that the cost and complexity of estate planning are obstacles for many testators and that the statutory will is an appropriate response to these problems).

49. Although this discussion focuses upon drafting, there are additional issues concerning the contributions of lawyers in business transactions and the adequacy of legal education in preparing students to become business lawyers. See generally Gilson, *supra* note 33.

50. Dissolution may be caused by the "express will" of any partner. UNIF. PARTNERSHIP ACT § 31(1)(b), (2). Other causes of dissolution include the termination of the partnership term, the express will of all partners, the expulsion of a partner, an event making it unlawful to continue the business, the death of a partner, the bankruptcy of a partner or the partnership, and a judicial decree. *Id.* § 31.

ments to maintain (or more precisely, not to dissolve) a partnership for a defined term. Although this point is sometimes misunderstood by scholars,⁵¹ the "indissoluble partnership" does not exist under partnership law.⁵²

The free dissolvability of partnerships limits the incentive to bargain, for although an agreement may render a premature wrongful dissolution⁵³ costly in some cases,⁵⁴ the power of a partner to escape an unhappy relationship cannot be abrogated by prior agreement. Thus, partnership law both encourages partners to bargain and provides these same individuals with an expeditious method of avoiding in many circumstances the adverse consequences of their bargaining.

This inflexibility reflected in the U.P.A.'s principle of free dissolvability is uncharacteristic of the Act's general tendency to defer to agreements altering its provisions. Free dissolvability, which is based upon arcane and misunderstood principles of agency law,⁵⁵ is an undesirable feature of partnership law and a principle much in need of reform. Pending that reform, free dissolvability operates as a disincentive to bargaining early in a partnership. If any partner is free to dissolve the partnership unilaterally and without regard to cause, then the benefits to be derived from serious bargaining and the development of a partnership agreement are lessened. With benefits diminishing and costs remaining stable, it is not surprising that many partners do not avail themselves of the bargaining opportunities provided by the U.P.A.

51. See, e.g., Goetz & Scott, *supra* note 21, at 1130 n.94 (indicating a partnership cannot be dissolved at the pleasure of one partner prior to expiration unless cause exists, but relying on a pre-U.P.A. case not reflective of present law).

52. For a more extensive discussion of the free dissolvability principle, see Hillman, *supra* note 30, at 691.

53. This is a dissolution in breach of an agreement establishing a term or undertaking for the partnership. See generally Hillman, *Misconduct as a Basis for Excluding or Expelling a Partner: Effecting Commercial Divorce and Securing Custody of the Business*, 78 NW. U.L. REV. 527, 537-39 (1983).

54. A wrongful dissolution may result in the imposition of sanctions under section 38 of the U.P.A. against the dissolving partner. These include (1) avoidance of the otherwise applicable liquidation right if the other partners elect to continue the business for the agreed term and indemnify the dissolving partner against certain liabilities; (2) a deferral of the dissolving partner's account settlement if the business is continued and a bond is posted to secure the interest; and (3) adjustment of the dissolving partner's account to disregard goodwill of the partnership and reflect damages resulting from the premature dissolution.

These sanctions will prove ineffective in many cases. Damages are rarely awarded, and continuation of the business without the dissolving partner may prove problematic. See Hillman, *supra* note 30, at 715-16; *infra* text accompanying notes 154-64.

55. See Hillman, *supra* note 30, at 701-07.

6. HIERARCHICAL PARTNERSHIPS

The above discussion has largely assumed that partnerships are egalitarian enterprises.⁵⁶ The key characteristic of such ventures is the relative equality between prospective and actual partners, a state conducive, at least in theory, to arms length bargaining. Admittedly, the U.P.A. contemplates more structured, or hierarchical, ventures, but it seems to contemplate bargaining as the triggering process for movement away from egalitarian norms.⁵⁷

Not all partnerships, however, fit this model. Some partnerships take on decidedly nonegalitarian characteristics over time as one or more participants assume positions of dominance.⁵⁸ Other partnerships are established as structured, hierarchical business organizations that continually admit new partners; any bargaining that resulted in the nonegalitarian structuring preceded the admission of the newer partners. In either case, the position of subordinate partners may more closely approximate that of employees than co-owners. Traditional assumptions concerning bargaining do not apply to these ventures.

One of the better examples of hierarchical partnerships is found in large partnerships of professionals such as corporate law firms. These partnerships provide good, but largely unstudied, illustrations of ventures with strong, nonegalitarian features.⁵⁹ Consider the plight of the large law firm's associate who labors five, seven, nine, or more years in the quest to become a partner. During this period, she knows little about the partnership or the income of partners. She is quite sure, however, that "partner" is a status worthy of pursuit. When the day of her reward arrives and she is invited to be a partner, the associate is presented with a copy of the partnership agreement, which obviously will provide a structure for the partnership quite different from that offered by the U.P.A.'s default provisions. This event is perfunctory; bargaining opportunities are nonexistent; the definitive agreement is an imposed agreement.⁶⁰ Although the associate may have

56. See *supra* text following note 21.

57. Most particularly, partners may waive their equal participatory rights and delegate management authority to one or more partners. See UNIF. PARTNERSHIP ACT § 18.

58. See, e.g., *Ferrick v. Barry*, 320 Mass. 217, 68 N.E.2d 690 (1946) (domination led to dissolution).

59. "When one thinks about it for a moment, it seems astonishing that law firms should have for so long remained almost unexplored in legal scholarship. These are, after all, social institutions of some prominence." Gordon, *Introduction to Symposium on the Corporate Law Firm*, 37 STAN. L. REV. 271 (1985). The *Stanford Law Review's* symposium offers one of the more complete and diverse treatments of large law firms, although the role of partnership law in regulating the relationships of members of these firms is largely ignored.

60. It is therefore treated under the discussion of obstacles to the development of definitive

reservations concerning the agreement, she has only two choices: (1) she can sign it anyway; or (2) she can find another job. Inevitably, she will sign.

This newly admitted partner, of course, is still in reality an employee.⁶¹ Her admission to partnership has given her a greater measure of security, status, and income, but it represents only a step in her movement within the highly structured firm. Bargaining among partners in the firm may indeed occur, but it is typically a post-admission phenomenon reflective of existing partners' attempts to reallocate income based upon perceptions of their values to the firm.⁶² The idea of bargaining at the stage of promotion of an associate to membership in the partnership is fanciful. The bargaining model of partnership formation, like most principles of the U.P.A., is simply irrelevant to this type of venture.⁶³

7. SUMMARY

Partnership law is not, as many believe, simply the "law of the agreement." The first step in evaluating the effectiveness of bargaining at the inception of a partnership is to recognize the limitations inherent in even serious attempts to develop an adequate partnership agreement. The second step, discussed below, is to consider the ongoing nature of the bargaining that occurs in a partnership.

C. *Re-Bargaining*

Under the traditional view of partnerships, bargaining is what partners are supposed to do at the beginning of their relationships. Somewhat naively, partners who successfully complete this process may believe that its product, the partnership agreement, will govern their future relationships. If partnership agreements represented discrete contracts performed over a short or even intermediate period of

agreements. In this case, there is a definitive agreement but the newly-admitted partner played no role in shaping its terms.

61. This may change, however, as she achieves status and assumes power within the partnership. *See infra* text accompanying notes 154-64.

62. It therefore more closely approximates re-bargaining. *See infra* text accompanying notes 65-76. *See generally* Gilson & Mnookin, *Sharing Among Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313 (1965).

63. The admission of the new partner does not cause the dissolution of the old partnership. *See* Bromberg, *Dissolution—Causes, Consequences, and Cures*, 43 TEX. L. REV. 631, 636-37 (1965). To existing partners, the admission is not an event requiring bargaining. To the new partner, on the other hand, it is the moment that most closely approximates the occasion for bargaining under the traditional U.P.A. approach to the development of partnership agreements. At this point, the opportunity is more theoretical than real.

time, there would be little cause for concern. Because the agreements normally attempt to provide the basis for regulating long-term relationships, however, they may prove over time incapable of adapting to the changing conditions affecting partnerships.⁶⁴ This gives rise to re-bargaining.

1. RE-BARGAINING EXISTING AGREEMENTS

Whether bargaining subsequent to the adoption of an agreement should be encouraged or discouraged depends upon the role assigned the initial partnership agreement.⁶⁵ If the first agreement is to provide the basis for business governance, and if partners are to be encouraged to devote their maximum efforts to bargaining at the early stages of a venture, re-bargaining should be discouraged. If, on the other hand, partnerships are viewed as fluid or evolving in character, the initial agreement should merely set the stage for subsequent adjustments of the relative rights and duties of partners. This latter view, which encourages re-bargaining, promotes flexibility at the expense of discouraging concerted bargaining efforts early in the life of a venture. The adoption of either view will have profound effects on the attitudes of partners in bargaining and their willingness to incur transaction costs in the stages of their partnerships.

The U.P.A. does not take a clear position on re-bargaining. Its deference to agreements is inconclusive, for the Act fails to address when those agreements may develop. Indeed, some of the most important features of the U.P.A. are the provisions rendering all partnerships freely dissolvable. These provisions almost certainly have the effect of encouraging post-agreement bargaining.⁶⁶ Like other "rational" individuals in constant pursuit of wealth maximization,⁶⁷ many partners will seek every opportunity to improve their positions at the expense of other participants in their ventures.⁶⁸ Since each partner has the unilateral power to end the relationship at any time

64. Recent writings on regional contracts, and in particular the work of Ian MacNeil, have influenced much of this analysis. *See supra* note 21. Professor MacNeil, however, presumably would disagree with many of conclusions.

65. The analysis of re-bargaining assumes partnerships either have or do not have agreements. Obviously, partnership agreements may cover only some issues, while not addressing others. The analysis can be adapted to this point by simply evaluating whether the matter under dispute in a partnership has been addressed in a prior agreement.

66. *See supra* text accompanying notes 50-55.

67. *See, e.g.*, R. POSNER, *ECONOMIC ANALYSIS OF THE LAW* 3 (1977).

68. Those who have observed a diverse group of partners may note that many do not seek advantages to the detriment of their co-participants. Perhaps this can be explained with reference to the value of a good reputation. A more plausible reason is that many individuals feel a moral obligation to adhere to their bargains.

and without regard to prior contrary agreements, the stage is set for re-bargaining if a partner's continued participation is perceived by other partners as more desirable than his withdrawal.

All of this suggests a certain mythical quality to the common, generalized view of the partnership agreement as the primary basis for business governance. The partnership agreement may represent only a first step in a long process of bargaining.⁶⁹ To the degree that stability of membership is perceived as important, there will be a constant movement within a partnership toward maintenance of a consensus. Although this may seem a desirable state for the law to encourage, it can work a considerable hardship on those who are asked to pay the price for the maintenance of the consensus. Stronger partners will ask for concessions from their weaker counterparts. If the "price" of the concessions is less than the "price" accompanying a premature dissolution, then the weaker party will grant them.⁷⁰

Plausible arguments can be advanced in support of the U.P.A.'s encouragement of the re-bargaining of existing agreements.⁷¹ Efficiency considerations, for example, may provide support for the process of continuous bargaining in, and easy dissolution of, partnerships.⁷² In balance, however, the U.P.A. seems to have gone too far. Individuals about to form a partnership should be permitted to assess the costs and benefits of developing a partnership agreement. They will know, of course, that the agreement can be little more than a constitutional document, but they need not be dissuaded from this effort by a principle that makes it impossible to preclude an abrogation of the contract through a dissolution of their partnership.⁷³ Although partners cannot preclude re-bargaining, they should be allowed to limit the activity more sharply than present law would

69. In some cases, however, it limits significantly re-bargaining opportunities. See *infra* note 76.

70. See *supra* note 54. The agreement may attempt to render a dissolution costly by making it wrongful. This is accomplished through the establishment of a partnership term. It can also increase costs by controlling the consequences of a dissolution through continuation agreements (giving nondissolving partners the right to continue the business) and by including covenants not to compete enforceable against a dissolving partner. In some cases, these may render dissolution prohibitively expensive for the dissolving partner. In cases in which the services of the dissolving partner are critical to the venture and continuation of the business without this individual is problematic, these contractual provisions prove less effective. See also *infra* text accompanying notes 154-64.

71. Cf. Hetherington & Dooley, *supra* note 6 (arguing for freer dissolvability of close corporations).

72. See Hillman, *supra* note 30, at 713-20.

73. For a discussion of problems of specific enforcement of partnership agreements, see Hillman, *supra* note 30.

permit.⁷⁴

2. "RE-BARGAINING" NON-AGREEMENTS

Re-bargaining in the absence of a definitive agreement may be viewed in a different light.⁷⁵ Although partners in rare cases may simply bargain to operate under the default provisions of the U.P.A., the application of those statutory principles more probably reflects the absence of bargaining at the inception of a relationship. Re-bargaining in such cases represents a process that has merely been deferred. If a consensus cannot be reached, the partnership will operate under the statutory default norms. But it may not operate this way for long. Free dissolvability permits a partner dissatisfied with these norms to end the relationship. The threat of dissolution may be sufficient to prompt serious bargaining at this stage in the life of a partnership. In short, the failure to bargain at the inception of a venture does not preclude, and in fact may prompt, continual bargaining during the life of a partnership.⁷⁶

74. There are limits, however, on the degree to which partners should be held to bad bargains. The interests to be protected are those of both satisfied and disgruntled partners within a venture. When it is clear that expectations fundamental to participation of the dissatisfied partner have been frustrated, and when damage to other partners from a termination of the partnership are minimal, dissolution may provide a sufficient safety valve to protect the interests of a partner from adverse consequences resulting from the bargain he once negotiated.

Although dissolution as a means of escaping a bad bargain should be available, its use should be far more restricted than is presently the case. If partners have not bargained for a term, dissolution by express will should remain an option available to any participant. If, however, the previous bargain includes mutual commitments respecting the duration of the venture, each partner has effectively waived the right to accomplish a unilateral dissolution through an expression of will. Under these circumstances, dissolution by decree upon showing of cause should be the exclusive method by which a single partner could prematurely cause a dissolution of the venture. This would limit to a considerable degree the "threat" of dissolution as a means of forcing re-bargaining. I offered a similar proposal in connection with dissolution of close corporations. See Hillman, *supra* note 14, at 69-87.

75. Although "re-bargaining" nonagreements is a misnomer, the term is used for consistency purposes.

76. Re-bargaining partial agreements is also noteworthy. Partners sometimes reach only very limited agreements at the inception of their ventures. For example, their agreement may be limited to an understanding that one partner will be entitled to disproportionate allocations of future profits. Under most circumstances, very narrow agreements of this sort do not limit the range of future bargaining, and free dissolvability may render such an understanding short-lived.

Limited agreements establishing the duration of a partnership are more problematic. Suppose, for example, partners agree only that their venture will have a term of ten years. The default norms will apply, subject to modifications that may result from future bargaining. The establishment of a term, however, may render subsequent bargaining more difficult to the degree dissolution is rendered costly to the partner who brings the relationship to an end prematurely. See *supra* note 54.

3. SUMMARY

Continual re-bargaining may be a sensible method for ordering within a partnership. Partners should, however, have the opportunity to reduce the uncertainty, costs, and instability associated with this process by developing agreements designed to minimize re-bargaining. If partners choose not to bargain at the inception of their relationships, they may merely defer bargaining to a point when it may prove problematic.

D. *Implied Agreements*

Even when there can be no reasonable finding of an express agreement, oral or written, numerous courts have found implied agreements altering statutory norms on such fundamental issues as payment of a salary⁷⁷ and duration of the venture. These findings have contributed significantly to the ad hoc and static nature of the case law on partnerships.

Implied agreements represent contradictory undercurrents in partnership law. At first glance, inferring agreements may appear consistent with the exalted role partnership law assigns the agreement. Yet the very bargaining underlying most agreements is often not present for those understandings that must be inferred. Indeed, inferring agreements may negate bargains, for the failure of partners to establish an express agreement on a particular issue will in some cases represent their understanding that the default norms of the U.P.A., applicable in the absence of agreements to the contrary, will be applied.⁷⁸

It is important to put into perspective the context in which the existence of implied agreements is tested. Almost invariably, disputes over implied contracts are resolved during the dissolution or winding up⁷⁹ phases of partnerships. Implied contracts may thus present a theoretical basis for accomplishing a fair allocation of assets at the close of a partnership's life.⁸⁰ "Fair" for this purpose means a result contrary to that which would occur through application of statutory norms.⁸¹ In such cases, the implied contract doctrine provides a con-

77. See *Busick v. Stoetzel*, 264 Cal. App. 2d 736, 70 Cal. Rptr. 581 (1968).

78. Cf. Easterbrook & Fischel, *supra* note 19, at 285 ("[T]he failure of [shareholders] to include a particular contracting term is ambiguous. It may mean that the parties did not want the term, but it *could* mean that they were ignorant.").

79. Winding up is the period between dissolution and termination, during which time the business of the partnership is brought to an end. UNIF. PARTNERSHIP ACT § 30.

80. Litigation between partners prior to dissolution is limited. See *infra* text accompanying notes 151-52.

81. The quest for fairness through avoidance of statutory norms is most clearly illustrated

venient means to achieve an equitable result even when the existence of implied agreements is, at best, tenuous. This approach is illustrated by the unrestrained enthusiasm of one court in advancing the case for implied contracts: "The courts have not hesitated to find an implied agreement [modifying statutory norms] when fair play impels such a result."⁸²

The problem comes in developing a framework for treating implied partnership agreements. If the just resolution of disputes between partners is an aim of partnership law, the implication of contracts may prove an effective, albeit frequently disingenuous, means of achieving this result. If, on the other hand, principles reasonably certain in application and likely to produce the most correct results in the largest number of cases are to be developed, and if incentives are to be provided for partners to express clearly their agreements, inferring contracts as a means of avoiding norms should be discouraged. The latter approach is more sensible and likely to benefit a greater number of partners over the long run.

Inferring agreements as a norm-defeating device should be discouraged. If the norms produce unjust results in a large number of cases, they should be revised; if the norms produce inequities in a small number of cases, they should be rendered more flexible by defining the circumstances under which courts may exercise discretion. Implied agreements should be treated as exceptional and recognized only under narrow circumstances and after the party asserting the agreement has established clearly the existence of conduct tantamount to consent.⁸³ This approach would both focus attention on the

by the large number of cases legitimizing the inference of agreements to pay salaries. Absent an agreement to the contrary, the U.P.A. precludes salary payments to partners. UNIF. PARTNERSHIP ACT § 18 (f). If one partner, for example, proves to be a laggard while another performs disproportionate services, one way to avoid unjust enrichment of the former and unjust detriment to the latter is to infer from the circumstances consent to the payment of a salary to the active partner. The result—avoidance of the U.P.A. default norm—may prove equitable, although the reasoning, which rests on fictional agreements, is strained. A few cases can be read to reject, or at least resist, the efficacy of implying contracts for the payment of a salary. *See, e.g.,* *Barthuly v. Barthuly*, 192 Neb. 610, 223 N.W.2d 429 (1974); *Levy v. Leavitt*, 257 N.Y. 461, 178 N.E. 758 (1931); *Corbet v. Corbet*, 24 Utah 2d 378, 472 P.2d 430 (1970). Implied agreements concerning partnership terms have also been found. *See supra* note 78. When partners enter long-term third-party commitments such as leases and financings, for example, they may expect their ventures to continue for a term at least coincident with those transactions. *See, e.g.,* *Zeibak v. Nasser*, 12 Cal. 2d 1, 82 P.2d 375 (1938). The inferences of the implied term cases, although sometimes strained, seem more sensible than those reflected in many of the decisions inferring agreements to pay salaries.

82. *Busick v. Stoetzel*, 264 Cal. App. 2d at 738, 70 Cal. Rptr. at 583 (1968).

83. *See Bemiss v. Widows' & Orphans' Home of Christian Church of Ky.*, 191 Ky. 316, 320, 230 S.W. 310, 312 (1921) ("[I]t is not imperatively essential that the agreement for compensation should be an express one, since it may be allowed under an implied one, but the

efficacy of the statutory default norms and encourage partners to express more clearly their agreements.

III. STATUTORY DEFAULT NORMS AS BARGAIN-SUBSTITUTES

Three features of partnerships and the U.P.A. may tend to subvert the agreement as the primary device of business governance. First, both the ability and the tendency of partners to develop truly comprehensive written agreements are limited. Second, the U.P.A. acts to undermine bargaining at the inception of a relationship by encouraging adjustments subsequent to the development of complete partnership agreements. Finally, the tendency of courts to infer agreements minimizes the role of early bargaining and may reflect implicit dissatisfaction with application of the U.P.A. default norms to partnership governance.⁸⁴ The existence of these forces tending to subvert agreements among partners necessitates careful consideration of the role and efficacy of the statutory default norms.

A. *Statutory Norms as "Gap Fillers"*

The default provisions of the U.P.A. serve to fill the gaps not covered by agreements.⁸⁵ In essence, the various norms established by the Act, applicable in the absence of agreements to the contrary, represent the supposed understandings partners most likely reach if they choose to bargain on the various issues. To the degree that these norms accurately reflect hypothetical agreements, they effect significant cost savings to partners by freeing them of the necessity to contract extensively.⁸⁶

There are some problems, however, with this view of the U.P.A. First, it may assume that partners are aware of the default provisions of the Act and knowingly adopt them in place of more individually tailored agreements. Such an assumption concerning knowledge of statutory standards may, if tested, prove unfounded. Alternatively, the view of the U.P.A.'s default provisions as cost-effective bargain substitutes would have merit if the statutory norms represent the types of agreements that most partners would reach if they chose to bargain specifically on the issues. Whatever the validity of such a conclusion when the norms were developed, the need for a reexamination of the default provisions as bargain substitutes is clear.

facts necessary to raise such an implication should be established by clear and convincing evidence.").

84. This latter factor is probably less common and therefore less important.

85. See *supra* note 22.

86. See, e.g., M. EISENBERG, *THE STRUCTURE OF THE CORPORATION* 9-12 (1976).

B. *The Adequacy of Statutory Norms as Bargain-Substitutes*

A number of the U.P.A.'s default provisions may seem counter-intuitive to many partners. The usefulness of the statutory norms as bargain-substitutes is undermined to the degree that partners are unaware of their existence and they would not have accepted the provisions if presented with alternatives. The very age of the U.P.A. norms is sufficient to create questions concerning their validity, particularly when one recalls that the norms have enjoyed an unusually privileged life, free of the pressure imposed by critical inquiry.

The following discussion will focus on default norms that address the decision-making process within partnerships, although other norms not discussed are equally deserving of attention. For example, the prohibition on salary payments to partners and the failure of the U.P.A. to require the performance of duties by a partner are examples of additional norms that might fall as a result of careful review.⁸⁷

87. Nowhere is an egalitarian view of partnerships more evident than in the U.P.A.'s prohibition on salary payments to partners. UNIF. PARTNERSHIP ACT § 18 (f); *see supra* note 81. When combined with the "equal participatory rights" accorded partners, the U.P.A. reflects a view of partnerships as ventures in which partners divide the fruits of their collective efforts. *See generally* Hillman, *Power Shared and Power Denied: A Look at Participatory Rights in the Management of General Partnerships*, 1984 U. ILL. L. REV. 865.

While this egalitarian premise may be accepted by many partners at the beginning of their ventures, over time the contributions of participants may become decidedly unequal. In some cases, this results from the extraordinary efforts of one or more partners. In other cases, however, movement away from the egalitarian model is attributable to the lack of efforts by certain partners. Given the principles of equal division of profits, equal participatory rights, and no disproportionate payments in the form of a salary, the Act might well include a mandate that partners have equal participatory duties to match their equal participatory rights. Although the U.P.A. does not expressly establish a duty to participate, a few cases have suggested such a duty. *See, e.g.,* Condon v. Moran, 11 N.J. Super. 221, 224, 78 A.2d 295, 297 (1951); *cf. Koenig v. Huber*, 87 S.D. 507, 509, 210 N.W.2d 825, 827 (1973) (suggesting, rather vaguely, the possibility of a duty to render services but finding the duty had not been breached); *see also* U.P.A. REVISION SUBCOMMITTEE REPORT, *supra* note 2, at 71-72.

Inequality of service contributions contrary to original expectations may lead to the implication of an agreement to pay a salary as a means of defeating application of the statutory norm or provide grounds for dissolving a partnership. *See supra* note 81.

It is ironic that the U.P.A. is protective of the right of each partner to perform services but is vague on the duty of partners to participate in their ventures. Inevitably, problems arise, but remedies, short of dissolution or the inference of agreements, are virtually nonexistent. For partnerships that are terminable at will, dissolution may prove an adequate remedy. But if a partnership has been established for a term, dissolution may prove undesirable to the partners desiring to continue the venture without the potential destructive effects of a dissolution.

This suggests that the addition of two new default norms may merit further consideration. First, the award of equal participatory rights could be balanced with a mandate of equal participatory duties. Further, a means of providing substance to the newly established duty would be to provide a mechanism for the reallocation of income through salary payments in the event that one or more partners fail to contribute services in line with the original understanding upon which the parties formed the partnership.

1. UNANIMITY AND MAJORITY VOTE STANDARDS

Although rule by majority is a well-established norm for the management of business enterprises, the majority occupies a precarious position in the management of partnerships. Only those disputes that "arise as to ordinary matters connected with the partnership"⁸⁸ are resolved by majority vote;⁸⁹ any act in contravention of the partnership agreement requires the consent of all partners.⁹⁰ Unanimity is a principle of such strength that one court has suggested that agreements permitting amendment by majority vote may be unenforceable when the approved change affects fundamental aspects of the relationship between partners.⁹¹

One obvious problem with the statutory guidelines is the division of partnership decisions into only two classifications: (1) matters that are ordinary, and (2) matters that without unanimous support would be in contravention of the agreement.⁹² This ignores an important range of decisions occupying the middle ground between "ordinary" matters⁹³ and decisions so fundamental as to represent amendments to the partnership agreement. Representing actions within the scope

88. This parallels the scope of the agency authority of a partner. See UNIF. PARTNERSHIP ACT § 9(1)-(2).

89. Absent a contrary agreement, voting in partnerships is not on the basis of relative ownership interests. Instead, each partner has one vote.

90. "Any differences arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between the partners may be done rightfully without the consent of all the partners." UNIF. PARTNERSHIP ACT § 18 (h); see also *id.* § 9 (describing the agency powers of partners and listing acts that require the consent of all partners).

91. See *McCallum v. Asbury*, 238 Or. 257, 393 P.2d 774 (1964) ("Fundamental changes in a partnership agreement may not be made without the consent of all the parties. This is true even though the agreement may provide that it can be amended by majority vote. The power to amend is limited by the rule that, unless unanimous, no amendment may be made in contravention of the agreement."); see also Note, *U.P.A. Section 18(h): Majority Control, Dissenting Partners, and the Need for Reform*, 13 U.C. DAVIS L. REV. 903 (1980).

92. This problematic division is not unique to the U.P.A. and was also evident in commentaries predating the Act. See, e.g., C. BATES, *THE LAW OF PARTNERSHIP* § 432 (1888); F. BURDICK, *SELECTED CASES ON THE LAW OF PARTNERSHIP* 511-12 (1898); E. GILMORE, *HANDBOOK ON THE LAW OF PARTNERSHIPS* § 125 (1911). But cf. J. STORY, *COMMENTARIES ON THE LAW OF PARTNERSHIP* 205 (Boston 1859) ("[T]he majority . . . have the right and authority to conduct the partnership business, within the true scope thereof, and dispose of the partnership property, notwithstanding the dissent of the minority.").

The problem is made even clearer under the English Partnership Act, which provides: "Any difference as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners." ENGLISH PARTNERSHIP ACT, 1890 53 & 54 Vict., ch. 39, § 24(8).

93. Not surprisingly, there are numerous disputes but no statutory guidelines concerning the nature of "ordinary" differences resolvable by simple majority vote. See generally A. BROMBERG, *supra* note 8, § 49.

of the contemplated business but not so extraordinary as to affect the basis of the relationship between partners, these decisions defy categorization within the U.P.A.'s guidelines.⁹⁴ For want of a better term, they may be described as "middle range decisions."⁹⁵

Although the U.P.A. ignores middle range decisions, the limitation of majority rule to ordinary matters effectively results in the imposition of a unanimity standard for all other decisions.⁹⁶ Partners thus have veto powers over a broad range of decisions, including many that were not the subjects of their initial agreements.⁹⁷ The breadth of veto powers accorded partners represents one of the more important and distinctive characteristics of the partnership form of organization.⁹⁸

Apart from interpretive problems arising because of imprecise drafting of the U.P.A., there remains the more important question of whether a broad unanimity standard is an appropriate bargain-substitute. Unanimity may seem to represent a principle designed to promote the maintenance of a consensus within a partnership by encouraging re-bargaining. Undoubtedly, the unanimity standard, when viewed in isolation from other features of partnership law, would offer a major device pressuring partners to maintain a consensus. Once again, however, the free dissolvability of partnerships assumes overriding importance as a stimulant for re-bargaining.

94. In discussing a normative model of decision making within close corporations, Professor Eisenberg described a comparable range of issues as follows:

The second category consists of decisions which are not in the ordinary course of business but are nevertheless within the general framework of the business as it exists when the decision arises. Examples include decisions to substantially expand plant capacity, to enter into a contract for the sale of a significant portion of the firm's output, or to recognize a union. Unlike decisions in the ordinary course, such decisions characteristically involve fairly high stakes, affect a relatively long timespan, occur with a low degree of frequency (although, taken as a class, with some regularity), and need not be made on the spot

M. EISENBERG, *supra* note 86, at 14.

95. This same neglect of the middle range is evident in section 9 of the U.P.A., which defines the agency power of a partner. After establishing the authority of a partner to act "for apparently carrying on in the usual way the business of the partnership," the section then goes on to describe, with greater specificity than that of section 18(h), matters requiring the consent of all partners.

96. *Cf.* A. BROMBERG, *supra* note 8, § 65, at 381-82 (indicating majority rule extends only to matters in the ordinary course of business).

97. This assumes that an agreement exists. When a partnership is formed without an agreement, the U.P.A. classification is even more problematic.

98. A further problem, which will not be addressed in this article, is the degree to which third parties are affected by the U.P.A.'s norms of decision making. *See, e.g.*, UNIF. PARTNERSHIP ACT § 9(4) ("No act of a partner in contravention of a restriction on authority shall bind the partnership to persons having knowledge of the restriction.").

This is clearest in the case of terminable at will partnerships, where dissolution can be accomplished without the threat of any sanctions imposed by law.⁹⁹ As has been discussed, re-bargaining in terminable at will, casually established ventures is an activity that is, and should be, encouraged by the U.P.A.¹⁰⁰ Re-bargaining is prompted when the threat of dissolution seems real. If the threat comes from the majority, the dissenting minority partner, if she wishes to avoid dissolution, will relent. A consensus is established, and the appearance of unanimity is maintained, not by virtue of the imposition of a standard of approval requiring unanimity, but rather because one partner desires to avoid the adverse consequences of a dissolution.¹⁰¹

Of course, the threat of dissolution will not prompt the same degree of bargaining if it is in the interests of all partners to maintain the relationship. Although a unanimity standard may prompt re-bargaining in such a case, the benefits of re-bargaining may be countered by other interests worthy of protection. When partners have previously engaged in extensive bargaining activities, as is the case in many fixed term partnerships, there is a limit to the degree to which re-bargaining should be encouraged through statutory norms. Other values, such as stability and order in management decisions, are also important, and the efficacy of unanimity as a bargain-substitute becomes more questionable.

If unanimity were not a statutory norm, would most partners adopt this standard by agreement? Once again, experience gained in

99. All partnerships are freely dissolvable, but dissolution in violation of an agreement may result in sanctions against the dissolving partners. The sanctions, however, are sometimes insignificant. See *supra* note 54.

100. See *supra* text accompanying notes 75-76.

101. This desirability of the unanimity standard cannot be evaluated without recognition of the dissolution potential inherent in all partnerships. Consider in this light the following example involving a terminable at will partnership formed by *A*, *B*, and *C*. A dispute arises concerning the purchase of equipment for the partnership that presumably is not an "ordinary" matter for this business. *A* and *B* support the purchase; *C* is in opposition and, accordingly, is in a position to block the purchase. But will he? If *C* exercises his veto, *A* and *B* may choose to dissolve the partnership as a means of eliminating *C*. If continued participation is more valuable to *C* than a dissolution of the partnership, he will relent and permit the purchase to occur. In this case, the will of the majority prevails even in the face of an ostensible unanimity requirement.

Now assume that at the inception of the terminable at will partnership the parties did bargain on one point. They agreed that decisions of the type now at issue will be made by majority vote. It might therefore appear that each partner has surrendered some of the bargaining potential that otherwise might be enjoyed if unanimity was required. But is it true under these circumstances that the will of the majority will prevail over the opposition of a single partner? Although he has accepted the principle of majority rule, *C* remains free to dissolve the partnership. If *A* and *B* regard this as both likely and undesirable, they will modify their decision. Majority rule has shifted to rule by consensus the equivalent of a unanimity standard.

the corporate context proves instructive.¹⁰² Unanimity is not a norm of decision-making in corporations.¹⁰³ It is, however, possible in most jurisdictions for shareholders to elect to operate under supermajority voting standards, including a standard of unanimity.¹⁰⁴ Unquestionably, unanimity provisions, or giving each shareholder a veto over corporate decisions, may prove useful planning devices in providing protections to minority shareholders. The acceptance of broad unanimity requirements in close corporations, however, is open to question. Even the proponents of this device counsel against its dangers,¹⁰⁵ and a recent study showed considerable resistance by lawyers to employing unanimity as a principle of corporate governance.¹⁰⁶

In short, the strongest case for a unanimity standard occurs with terminable at will partnerships. These ventures, however, operate under other pressures imposed by the U.P.A., such as free dissolvability, that may effectively prompt the desirable process of re-bargaining. As a norm for management decisions in more long-term relationships, unanimity is a poor bargain-substitute. Majority approval should provide a sufficient degree of support for decisions in the middle range. Only amendments to the partnership agreement and the most fundamental matters affecting the business need be subjected to the rigors of a unanimity standard.

2. ALLOCATION OF VOTING POWER

Related to the question of the degree of support required to ratify business decisions is the issue of how voting power will be allocated within partnerships. Originally, voting within both corporations and partnerships was on the basis of one vote for each owner. Corporate law long ago abandoned this principle in favor of voting on the basis

102. See, e.g., F. O'NEAL, *CLOSE CORPORATIONS: LAW AND PRACTICE* §§ 4.01-.30 (1971).

103. Unanimous approval, however, may still be required to support acts that are ultra vires, which is a limited doctrine and decreasing in importance. See generally H. HENN AND A. ALEXANDER, *LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* § 184 (1983). Unanimity may also be relevant to the adoption of shareholder agreements affecting management. See, e.g., CAL. CORP. CODE § 186 (West 1977).

Supermajority voting requirements short of unanimity may apply to certain extraordinary transactions. See, e.g., MODEL STATUTORY CLOSE CORP. SUPP. §§ 30-31 (Supp. 1986).

104. See, e.g., CAL. CORP. CODE §§ 152-153, 204(a)(9) (West 1977 & Supp. 1986). See generally F. O'NEAL, *supra* note 102, § 4.17; Empirical Research Project, *supra* note 7, at 934-39.

105. See, e.g., F. O'NEAL & R. THOMPSON, *O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS* § 9.09 (1985).

106. See Empirical Research Study, *supra* note 7, at 1011; see also F. O'NEAL, *supra* note 102, § 4.04.

of relative ownership interests.¹⁰⁷ One partner, one vote, however, remains the default norm for partnership voting.

The equal distribution of voting power among partners may seem to represent a fair basis for business governance. Indeed, it is unobjectionable for the large number of egalitarian partnerships in which the contributions and interests of partners are equal. In these types of partnerships, it makes no difference whether each partner is entitled to one vote or whether voting is allocated on the basis of ownership interests; under either system, the allocation of voting power would remain the same. The question concerning the adequacy of the statutory norm as a bargain-substitute concerns those partnerships in which ownership interests are not identical. In ventures of disproportionate ownership interests, partners may assume, incorrectly, that voting power will correspond with relative interests in profits.¹⁰⁸ This assumption would not be unreasonable, for that is exactly the mode of voting in close corporations.

A norm offering a more sensible bargain-substitute would allocate voting power on the basis of relative interests in profits and losses. In egalitarian partnerships, where profits and losses are shared equally, this would have no effect on voting. In nonegalitarian partnerships, it would give partners with greater stakes voting power corresponding with their interests. This is more likely to conform with the assumptions of partners than the present default norm on voting.

3. FURTHER EVALUATIONS

Undoubtedly, many of the U.P.A.'s default norms prove sensible bargain-substitutes for partners. Some, however, do not fill this function well. Until more comprehensive review of these aged norms is accomplished, claims asserting the efficacy of modern partnership law must be viewed with suspicion.

IV. FIDUCIARY RESPONSIBILITIES AND PRIVATE ORDERING

The status of partners as fiduciaries with respect to each other is an established tenet of partnership law.¹⁰⁹ But what does it mean

107. See, e.g., V. MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 476(a) (1886).

108. Cf. J. STORY, *supra* note 92, § 123, at 205 ("[T]he general rule would seem to be, that each partner has an equal voice, however unequal the shares of the respective partners may be, because in such a case, each partner has a right to an equal share of the profits.") (emphasis added).

109. See generally A. BROMBERG, *supra* note 8, § 68; Beane, *The Fiduciary Relationship of a Partner*, 5 J. CORP. L. 483 (1980); Note, *Fiduciary Duties of Partners*, 48 IOWA L. REV. 902 (1963).

when we label a partner a fiduciary and what functions are served in measuring the conduct of a partner against strict fiduciary standards?¹¹⁰ And what is the basis for and limitations on applying fiduciary standards to a relationship that is essentially contractual in nature?

The relationship between fiduciary standards and bargaining within partnerships is one of the more important aspects of partnership law. If bargaining is truly effective as a means of private ordering, the role of fiduciary standards should be limited to insuring proper conditions for bargaining. Under this rather narrow, supplemental approach, fiduciary responsibilities would preclude deceitful activities, such as theft and embezzlement, and promote full disclosure in dealings among partners. If, on the other hand, bargaining fails to provide an adequate basis for private ordering, then standards of fiduciary responsibility may assume greater importance and in fact supersede bargaining in providing a framework for regulating the relationships between partners.

One of the problems of evaluating the role of fiduciary standards is the marked absence of reasoning on this subject in case law. Too often, reported cases begin with a proclamation of the status of partners as fiduciaries, continue with rather colorful and exaggerated rhetoric intended to buttress this conclusion, and conclude with a finding that a partner has, or has not, fulfilled his responsibilities. What is missing is a refinement of the meaning of, and reason for, enforcement of an imposed code of conduct on partners,¹¹¹ and, more importantly, an explicit recognition of limitations on the use of fiduci-

110. "[T]o say that a man is a fiduciary only begins [the] analysis, it gives direction to further inquiry. To whom he is a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?" *SEC v. Cherney Corp.*, 318 U.S. 80, 85-86 (1943).

111. This problem is shared with corporate law:

The usefulness and actual effect of such an umbrella term to designate so many different kinds of individuals in divergent capacities with duties of differing character and intensity may well be seriously questioned. The concept of a "fiduciary" may serve as a useful legal fiction to stimulate development of new or expanding obligations by analogy to the seminal concept of the trustee. On the other hand, clarity of description and precision in defining duties might at this stage be better achieved through abandonment of so amorphous a term in favor of developing a more precise set of notions of duty and responsibility in connection with each of the separate capacities now lumped within the broad and nebulous term "fiduciary."

Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 *BUS. LAW.* 883, 887 (1976). The corporate law literature on fiduciary responsibilities is extensive. See, e.g., Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 *COLUM. L. REV.* 1403 (1985); Chirelstein, *Towards a Federal Fiduciary Standards Act*, 30 *CLEV. ST. L. REV.* 203 (1981); Easterbrook & Fischel, *Corporate Control Transactions*, 91 *YALE L.J.* 698

ary standards to preclude all attempts at private advantage within partnerships.¹¹²

The following discussion will explore the relationship between bargaining and fiduciary responsibilities and consider the degree to which fiduciary standards can regulate the quest for private advantage within partnerships.

A. *Standards in Search of a Premise*

A paramount difficulty in any assessment of fiduciary responsibilities under partnership law is identifying the premise underlying the imposition of this code of conduct. The following discussion suggests that fiduciary standards may be justified under four lines of reasoning that both overlap and, to some degree, reflect inconsistent objectives.

1. MORAL MANDATE

There is a moral theme to the concept of fiduciary responsibilities.¹¹³ It may thus be argued that the close relationships and mutual trust supposedly characteristic of partnerships require the development of legal principles insuring impeccable conduct by business partners.¹¹⁴ Partners are entrusted¹¹⁵ with the fortunes of their colleagues. Uncompromised good faith, minimization of self-interest, and furtherance of the collective good, should, under this view, be the principles guiding the behavior of partners.¹¹⁶

The morality component of fiduciary standards can be supported as an attempt to effectuate intentions of contracting partners; as such, it could readily be incorporated within the bargain-substitute approach discussed below.¹¹⁷ The tone, enthusiasm, and uniformity evident in judicial expressions of the standard, however, suggest a life for the moral mandate imposed on fiduciaries independent of the expectations and assumptions of the "average" partner. Even the

(1982); Marsh, *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35 (1966). See also U.P.A. REVISION SUBCOMMITTEE REPORT, *supra* note 2, at 78-79.

112. The nondisclosure cases provide, perhaps, exceptions to this criticism. See *infra* text accompanying notes 140-50.

113. Cf. Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 829-30 (1983) ("Courts regulate fiduciaries by imposing a high standard of morality upon them. This moral theme is an important part of fiduciary law. Loyalty, fidelity, faith, and honor form its basic vocabulary.").

114. Many extend this argument to close corporations. See, e.g., *Helms v. Duckworth*, 249 F.2d 482 (D.C. Cir. 1957).

115. See Frankel, *supra* note 113, at 800 n.17.

116. See *infra* notes 122-24.

117. See *infra* text accompanying notes 130-37.

U.P.A. does not clearly relegate fiduciary responsibilities to the status of default norms,¹¹⁸ although partners can and do bargain on the subject.¹¹⁹

This morality theme is reflected in much of the *language* of reported decisions, and courts have consistently articulated a high standard against which the conduct of partners is to be measured. Judge Cardozo bears much of the responsibility, and his statement on this issue, although dictum, is one of the most frequently quoted and elegant formulations of the law:

[Partners] owe to one another . . . the duty of finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this, there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty. . . . Only thus has the level of conduct for fiduciaries been kept at a higher level than that trodden by the crowd.¹²⁰

118. References to fiduciary responsibilities appear only in section 21 of the U.P.A., which provides:

(1) Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him *without the consent* of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

(2) This section applies also to the representatives of a deceased partner engaged in the liquidation of the affairs of the partnership as the personal representative of the last surviving partner.

UNIF. PARTNERSHIP ACT § 21 (emphasis added).

119. They do this by obtaining the consent of other partners to conduct that might be considered objectionable under fiduciary standards. See, e.g., *Ben-Dashan v. Plitt*, 58 A.D.2d 244, 396 N.Y.S.2d 542 (1977). This is contemplated by the language of section 21 of the U.P.A. See *supra* note 118. See generally Reynolds, *Loyalty and the Limited Partnership*, 34 U. KAN. L. REV. 1, 12 (1985) ("To the extent disclosure of a questioned transaction is characterized as leading to an implication of consent by the other partners, the transaction will be given effect. The substantive fairness of the questioned transaction is not in issue; or, the issue of the transaction's fairness is subsumed into the finding of agreement."). This seems to be particularly common in limited partnerships, and may approach standard practice in large, public syndications of limited partnership interests. See, e.g., *Bassan v. Investment Exch. Corp.*, 83 Wash. 2d 922, 524 P.2d 233 (1974). In many cases, the disclosures precede likely *future* conflicts of interest, and we can question the degree to which consent is bargained for under these circumstances. For an example of a prospectus including disclosures of future conflicts in interest, see A. CONARD, R. KNAUSS, & S. SIEGEL, *ENTERPRISE ORGANIZATION* 457-58 (1982) (The authors precede the excerpted agreement with the question: What remains of the fiduciary obligation of the general partners?).

For further discussion of disclosure components of fiduciary responsibilities, see *infra* text accompanying notes 140-50.

120. *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

Cardozo was not alone. Rhetorical statements on this issue abound, with such comments as "there is no stronger fiduciary relation known to the law than that of a copartnership"¹²¹ and admonitions concerning the duty of "utmost good faith"¹²² dominating judicial analyses of fiduciary responsibilities. The fervor of such statements and the unqualified manner in which they are offered suggest a moral mandate that no partner may attempt to secure any private advantage at the expense of other partners.¹²³

Although colorful,¹²⁴ the judicial rhetoric inevitably overstates the standard of conduct the law actually imposes on partners. If partners truly are fiduciaries, they are a unique species of this group and cannot be subjected to traditional standards applicable to other types of fiduciaries. The very concept of "fiduciary" connotes undivided loyalty and disinterested representation.¹²⁵ In theory, a fiduciary is a principal to whom another entrusts money.¹²⁶ The fiduciary as joint owner, although not unknown, is something of a contradiction in terms. Partners, on the other hand, are always joint owners.¹²⁷ The principal objective of each is to maximize personal gain. Partners are not disinterested trustees, and the likelihood that most partners operate under a "punctilio of an honor the most sensitive"¹²⁸ standard is remote.¹²⁹

121. *Salhinger v. Salhinger*, 56 Wash. 134, 137, 105 P. 236, 237 (1909).

122. The case law is too voluminous to cite in full. See, e.g., *Couri v. Couri*, 95 Ill. 2d 91, 94, 447 N.E.2d 334, 337 (1983) ("utmost good faith and honesty"); *Moser v. Williams*, 443 S.W.2d 212, 215 (Mo. Ct. App. 1969); *Veale v. Rose*, 657 S.W.2d 834, 837 (Tex. Civ. App. 1983) ("utmost degree of good faith and honesty"); *Barker v. Smith*, 294 S.E.2d 919, 926 (W. Va. 1982) ("highest degree of good faith").

123. See, e.g., *Latta v. Kilbourn*, 150 U.S. 524, 541 (1893) (a partner "cannot carry on the business of the partnership for his private advantage"); *Page v. Page*, 55 Cal. 2d 192, 197, 359 P.2d 41, 44, 10 Cal. Rptr. 643, 646 (1961) ("We have often stated that partners are trustees for each other, and in all proceedings connected with the conduct of the partnership every partner is bound to act in the highest good faith to his copartner, and may not obtain any advantage over him by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind.").

124. See, e.g., *Fouchek v. Janicek*, 190 Or. 251, 225 P.2d 783, 793 (1950) ("The true rule is: When a partner wrongfully snatches a seed of opportunity from the granary of his firm, he cannot, thereafter, excuse himself from sharing with his copartners the fruits of its planting, even though the harvest occurs after they have terminated their association.").

125. See *Beane*, *supra* note 109, at 486-87. This is reaffirmed in frequent references to partners as "trustees." See, e.g., *Page v. Page*, 55 Cal. 2d 192, 197, 359 P.2d 41, 44, 10 Cal. Rptr. 643, 646 (1961). *But cf.* RESTATEMENT (SECOND) OF AGENCY § 13 comment a (1958) ("The agreement to act on behalf of the principal causes the agent to be a fiduciary, that is, a person having a duty . . . to act *primarily* for the benefit of another in matters connected with his undertaking.") (emphasis added).

126. See *Frankel*, *supra* note 113, at 800.

127. UNIF. PARTNERSHIP ACT § 6(1).

128. See *supra* text accompanying note 120.

129. A number of commentators have recognized that application of broad fiduciary

2. BARGAIN-SUBSTITUTES

A somewhat different justification for fiduciary standards attempts to accommodate an imposed code of conduct with the bargaining process.¹³⁰ Arguably, partners implicitly accept fiduciary standards as part of their bargained-out arrangements. Legal standards in the form of fiduciary rules lower the costs of contracting and “approximate the bargain the parties themselves would have reached had they been able to negotiate at low cost.”¹³¹ Under this view, the conduct of a partner should be measured not against a rigid moral standard but rather in light of its conformity to the type of agreement that would have been reached if the partners contracted explicitly on the issue.¹³²

a. Moral Mandate and Bargain-Substitute Approaches Distinguished

Although they overlap, the morality and implied bargain approaches to fiduciary responsibility may yield inconsistent results. The moral mandate view lends itself more readily to the application of strict, and possibly inflexible, standards of conduct. In defining fiduciary responsibilities, courts are free to borrow from the development of standards applied to fiduciaries in other contexts. Although some misconduct by partners may frequently escape regulation under this approach, the rigor of the standard may have an *in terrorem* effect in prompting some partners to act more “honorably” than they would if subject to a weaker code of behavior.

Evaluating the implied bargain, on the other hand, permits a more flexible development of fiduciary standards specifically tailored to partnerships and the conflicts of interests inherent in these ventures.¹³³ Standards developed to regulate other fiduciaries would not control the conduct expected of partners. For this reason, the bargain-substitute approach tolerates a greater degree of self-interest pursuit than would be allowed of more disinterested fiduciaries, such as trustees. It therefore offers some promise as a basis for the development of more predictable and realistic rules regulating the conduct of partners and providing a framework for bargaining.

principles varies depending upon the contexts in which they are being enforced. See, e.g., Scott, *The Fiduciary Principle*, 37 CALIF. L. REV. 539, 541 (1949).

130. See Easterbrook & Fischel, *supra* note 19, at 291-97.

131. *Id.* at 291.

132. “If a court is unavoidably entwined in a dispute, it must decide what the parties would have bargained for had they written a completely contingent contract.” *Id.* at 293.

133. *But cf.* Frankel, *supra* note 113, 832-36 (arguing for a single fiduciary law applicable to all who occupy this status).

b. Bargain-Specific Versus Bargain-General

The bargain substitute approach is in need of further refinements. For example, whether the analysis is bargain-specific, focusing on how a particular set of partners would have resolved the issue, or bargain-general, evaluating how mythical "reasonable" partners would have responded, will have important consequences for the form in which fiduciary principles develop and the responses of partners to those standards.

The bargain-specific analysis represents a methodology more consistent with traditional views of partnership law because it attempts to implement specific, albeit hypothetical, bargains. Any deviation from that fabricated past bargain requires consent, which in turn activates the bargaining process. *If* partners are able to construct, without the assistance of courts, the fictional agreements under which they operate and which no longer prove satisfactory, the bargain-specific approach accommodates ongoing bargaining as a means of private ordering within partnerships.

The bargain-specific approach does present some problems. The task of reconstructing nonexistent bargains is both imposing and arbitrary. The timing is also problematic, for the determination of the content of the bargain, a judicial function, occurs in the course of litigation and at a point when re-bargaining may effectively be foreclosed. Moreover, if truly applied as an attempt to construct specific bargains, the bargain-specific approach limits courts to an ad hoc dispute resolution role and precludes the development of principles that can be applied more systematically.

A further problem is that the bargain-specific approach emphasizes the past. Presumably, the "bargain" under this analysis is determined late in the life of a partnership with reference to a fictional agreement developed at the beginning of the venture. This retrospective character of the bargain-substitute approach is consistent with traditional views of partnership bargaining as an activity largely preceding formation of a partnership. If applied in this fashion, however, the approach exalts the past and ignores the effect of post-commencement developments that might have led to an entirely different bargain between the partners.¹³⁴

By focusing on the expectations partners generally have with respect to the standard of conduct for their colleagues and measuring the conduct of specific partners against that standard, the bargain-

134. The criticism is more applicable to the bargain-specific than the bargain-general approaches described in this section.

general approach avoids the retrospective orientation of the bargain-specific mode and offers promise as a basis for the development of a more systematic code of conduct for partners. Because it implicitly denigrates specific bargains in the effort to develop more broadly applied principles, however, the bargain-general approach is inconsistent with the exalted role accorded specific agreements under partnership law.¹³⁵ For this reason, the "bargain-general" label is misleading. Misnomer aside, the approach does offer the advantage of providing, through the development of standards, a clear default reference point from which partners may depart, if they so choose, through bargaining. The standards may be both procedural and substantive in character. More modern close corporation statutes may prove useful, although somewhat limited, models in this regard.¹³⁶

Whether rules capable of systematic application will emerge from a bargain-general approach, however, is open to some question. If bargain-general evaluations develop utilizing only a fairness standard to measure conduct,¹³⁷ and if judicial opinions are not supported by adequate reasoning so as to have some value as precedents, then the approach will reflect the same ad hoc and arbitrary qualities limiting the usefulness of bargain-specific evaluations. If, on the other hand, the bargain-general approach prompts more systematic rule development, then it may offer a useful basis for refining and clarifying partnership law's fiduciary standards.

In short, the bargain-specific approach promotes ad hoc dispute resolution and is consistent with the exalted role assigned the initial agreement under partnership law. The bargain-general discounts the agreement that might have been developed by a particular group of partners and seeks instead to fashion principles for general application based upon mythical reasonable partners. Ideally, the guidelines are developed systematically, and if this occurs, their predictive qualities would enhance bargaining within partnerships.

135. An alternative would permit an amalgamation of the two approaches. A court could follow a bargain-general resolution unless it determines that there is something unique about the relationship between a given set of partners justifying a bargain-specific means of resolving the dispute.

136. See, e.g., REVISED MODEL BUSINESS CORP. ACT §§ 8.31-.32 (1984) (Director Conflict of Interest and Loans to Directors); CAL. CORP. CODE § 310 (West 1977) (Contracts in Which Director Has Material Financial Interest; Validity). Although these statutes are sometimes described as regulating "conflicts of interest," they cover only some transactions that might fall within this description. For a good analysis of the types of "conflicts" that occur in the corporate setting, see Marsh, *Are Directors Trustees?*, 22 BUS. LAW. 35, 57-73 (1966).

137. See *infra* text accompanying notes 138-39.

3. FAIRNESS

Another view of fiduciary responsibilities is that partners should treat each other fairly.¹³⁸ The standard of "fairness" is sufficient, proponents argue, to permit courts to achieve justice in the wide variety of disputes with which they are faced; greater specificity, the argument continues, is not worth the cost. . . .¹³⁹

Undoubtedly, developing a comprehensive "code" of fiduciary responsibility would prove both costly and futile. The other extreme of simply delegating to courts the tasks of making ad hoc and unsystematic evaluations of fairness, however, is also unacceptable. What do we mean when we require partners to act "fairly," and how can such a vague standard provide any reasonable guidance for partners? More precisely, does the concept of fairness preclude any attempt to secure private advantage within a partnership? What is the relationship between fairness and the continuous bargaining that takes place within a partnership? Is fairness simply a pseudonym for disclosure? The need for flexibility does not preclude development of an underlying framework for addressing the inevitable conflict between partners as individuals and partners as members of a collective.

As the starting point for developing a standard, "fairness" is unobjectionable. Indeed, a more developed standard of fairness may offer advantages over the moral mandate and bargain substitute approaches discussed above. Unlike the moral mandate approach, a fairness standard may accept, as any realistic standard must, that partners will pursue their self-interests and that the principal objectives of fiduciary standards under partnership law should be to provide a check on the more abusive aspects of the quest for private advantage. In contrast to the bargain substitute approach, a fairness inquiry need not be limited to the partnership bargain, whether real, imagined, or imposed. Holding partners to their original bargains may in some cases produce unjust results; this may occur, for example, when those first agreements fail to anticipate the effect of changing conditions on the relationships between partners. If fairness is a

138. See, e.g., W. KLEIN & J. COFFEE, *supra* note 29, at 69-77.

139.

Outcomes in decided cases can be recited to provide examples of conduct that has been found to be on one side of the line or the other. Yet the line remains unclear, the vagueness remains— perhaps unavoidably so, since the principle is designed to cover situations of such wide variety that it would be impractical to try to anticipate and provide clearer rules even for those most likely to occur. Greater specificity is simply not worth the cost.

Id. at 70. The commentary following this statement is well worth reading. *Id.* at 70-77.

superseding principle, it significantly affects the process of bargaining as a means of private ordering within partnerships.

Absent much more thorough and diverse considerations of this rather basic question concerning the role of law in facilitating or supplanting private ordering among business partners, conclusions concerning the impossibility of more systematic development of the fairness standard are premature. The attractiveness of the fairness standard lies in its promise rather than its contributions to date.

4. DISCLOSURE

Nondisclosure is perhaps the most characteristic feature of fiduciary responsibility litigation. The essence of the obligation to share information is found not in the narrow provisions of the U.P.A. addressing disclosures,¹⁴⁰ but rather in the "fiduciary" quality of the relationship between partners.¹⁴¹

Nondisclosure need not be combined with other misconduct to constitute a breach of fiduciary responsibilities.¹⁴² Indeed, in the very decision in which he gave us the "punctilio of honor" standard,¹⁴³ Cardozo stressed not the attempt for private advantage but rather the secrecy surrounding that activity as the essence of the culpable participant's wrongdoing.¹⁴⁴ Had this individual simply disclosed his

140. For the most part, these provisions emphasize passive rather than affirmative disclosure duties. *See, e.g.*, UNIF. PARTNERSHIP ACT § 19 ("The partnership books shall be kept, subject to any agreement between the partners, at the principal place of business of the partnership, and every partner shall at all times have access to and may inspect and copy any of them."); *id.* § 20 ("Partners shall render on demand true and full information of all things affecting the partnership to any partner . . ."); *see also* UNIF. PARTNERSHIP ACT § 22 (the right to the account suggests an affirmative obligation to disclose); *cf.* *Fouchek v. Janicek*, 190 Or. 251, 225 P.2d 783, 792 (1950) ("Good faith not only requires that a partner should not make any false statements to his partners, but also that he should abstain from any false concealment.").

141. *See, e.g.*, *Vogel v. Brewer*, 176 F. Supp. 892 (D. Ark. 1959); *Marsh v. Gentry*, 642 S.W.2d 574 (Ky. 1982); *Stark v. Reingold*, 18 N.J. 251, 113 A.2d 679 (1955); *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928); *Fouchek v. Janicek*, 190 Or. 251, 225 P.2d 783 (1950) (treating information as an asset of the partnership); *Bovy v. Graham, Cohen & Wampold*, 17 Wash. App. 567, 64 P.2d 1175 (1977); *see also Reynolds, supra* note 119, at 11-12 ("In the general partnership cases . . . the inquiry generally stops with an evaluation of disclosure. If there is no disclosure and a given transaction can be characterized as leading to a 'secret profit,' the ensuing accounting in favor of the uninformed partner is nearly automatic.").

142. Nondisclosure, however, may resolve doubts concerning the acceptability of conduct and render wrongful otherwise marginal activities.

143. *See supra* text accompanying note 120.

144. The case involved a joint venture that operated a hotel under a long-term lease. The two venturers were Salmon, the manager, and Meinhard, the passive investor. As the lease neared expiration, one of the venturers secretly and for his own benefit negotiated a new lease on a large block of property, including the site of the hotel; the lease required substantial

intention to abandon the venture¹⁴⁵ and exploit the opportunity alone, his conduct apparently would have risen above the "morals of the marketplace," and his "duty of finest loyalty" would have been fulfilled.¹⁴⁶ Thus, otherwise acceptable conduct may become wrongful if shrouded in secrecy.¹⁴⁷

What objectives are advanced through disclosure obligations? Whether disclosure requirements stand alone or merely as a part of the more comprehensive moral mandate and bargain-substitute approaches,¹⁴⁸ it is the consequences of disclosure, rather than the mere act of disseminating information, that supports disclosure obligations as a component of fiduciary responsibility.¹⁴⁹ Disclosure levels the playing field and prompts response, which in turn may profoundly affect private ordering, or re-ordering, within the partnership.¹⁵⁰ So viewed, disclosure performs an important function in facilitating bargaining.

Its effectiveness in performing this function, however, should not be overstated. The disclosure standard presupposes supplementary

redevelopment activities. Meinhard learned of the transaction only after the new lease had been signed:

The pre-emptive privilege, or, better, the pre-emptive opportunity, that was thus an incident of the enterprise, Salmon appropriated to himself in secrecy and silence. He might have warned Meinhard that the plan had been submitted, and that either would be free to compete for the award. If he had done this, we do not need to say whether he would have been under a duty . . . to hold the lease so acquired for the benefit of a venture then about to end, and thus prolong by indirection its responsibilities and duties. The trouble about his conduct is that he excluded his coadventurer from any chance to compete, from any chance to enjoy the opportunity for benefit that had come to him alone by virtue of his agency. This chance, if nothing more, he was under a duty to concede.

Meinhard v. Salmon, 249 N.Y. 458, 460, 164 N.E. 545, 547 (1928).

145. Since the venture was about to end, it is comparable to a terminable at will partnership.

146. Admittedly, Cardozo was somewhat ambiguous on this point. *See supra* note 144.

147. *See also* Marsh v. Gentry, 642 S.W.2d 574, 576 (Ky. 1982) ("Had [the nondisclosing partner] made a full disclosure to his partner of his intentions to purchase the partnership property, [the other partner] would not later be heard to complain of the transaction.").

148. Although nondisclosure may itself be sufficient to constitute a breach of fiduciary duty by a partner, disclosure alone is not sufficient to embrace all responsibilities of partners as fiduciaries.

149. This portion of the discussion largely assumes disclosures are made at a time coincident with the transactions to which they relate; disclosures of possible future transactions, however, may also occur at the time a partnership is established. *See supra* note 119.

150. Disclosure may, for example, prompt other partners to (1) pursue opportunities otherwise restricted by their fiduciary obligations, (2) disclaim the continuance of their partnership and seek dissolution, (3) eliminate from the venture the partner whose activities exceed accepted limits on the pursuit of self-interest, (4) capture gains properly those of the partnership, (5) block through litigation conduct they perceive as objectionable, or (6) consent to the transaction, perhaps exacting concessions if their bargaining leverage is sufficient.

principles defining the type of conduct that must be disclosed. At one extreme, theft presents the obvious case; more subtle forms of the pursuit of self-interest, however, are problematic. Even assuming an understanding of the circumstances under which disclosure is required, it does not follow that the "consent" sufficient to ratify conduct will represent an arms length and willing concurrence by equal partners. For a variety of reasons, some of which are discussed below, securing consent may prove a perfunctory event without elements of bargaining.

B. *The Role of Fiduciary Responsibilities in Facilitating Private Ordering within Partnerships*

Partners pursue their self-interests. They do so in the development of an agreement establishing their partnerships, and they do so throughout the lives of their ventures. This takes place even in the face of a continuous stream of judicial opinions exhorting partners to subordinate their self-interests to the collective good.

Even without regard to the excesses of rhetoric, it is easy to overstate the importance of fiduciary responsibilities in controlling the conduct of partners. In many ways, the very individuals the fiduciary standard is intended to protect face very significant disincentives to asserting a claim based upon supposed improper conduct by one of their co-partners. Generally, litigation of fiduciary issues is confined to the dissolution phase of a partnership's life.¹⁵¹ A partner otherwise satisfied with her venture may face a hard choice in deciding whether to continue the partnership or destroy the venture as a means of seeking relief for objectionable conduct by a co-partner.¹⁵²

Partners may, of course, secure ratification of their conduct through bargaining. These are the cases that never achieve the status of reported litigation. To secure the consent of other partners, the partner proposing to act may be forced to make concessions concerning either his actions or other aspects of his relationship with the other partners. Initiation of bargaining displays willingness to accept

151. "[T]he general partnership typically enters the case reports in something of a *post mortem* posture. Death, dissension, and other contingencies having arisen, the partners personally go to equity to divide up the leftovers." Reynolds, *supra* note 119, at 10-11. This is largely because of case law precluding litigation between partners prior to a complete accounting and making dissolutions prerequisites to such accountings. See generally A. BROMBERG, *supra* note 8, §§ 69-72. Courts often are reluctant to interfere in disputes between partners. See, e.g., Schuler v. Birnbaum, 62 A.D.2d 461, 405 N.Y.S.2d 351 (1978); see also U.P.A. REVISION SUBCOMMITTEE REPORT, *supra* note 2, at 13, 58-59, & 80.

152. To many, litigation is a process antithetical to the close trust and cooperation supposedly required of partners. This generalization is dangerous, however, for the success of some ventures is not in the least dependant upon cooperation between the partners.

costs. The broader the scope of fiduciary responsibilities, the greater the price charged for the pursuit of self-interest.

The difficult question is identifying the type of conduct that might, without the consent of other partners, be proscribed under fiduciary standards. Most successful challenges to the actions of fiduciaries fall within a category that may loosely be described as "misappropriation" of partnership assets. The line between "misappropriation" and acceptable "appropriation" is not well defined. As the following discussion will demonstrate, partners may pursue their self-interests in a wide variety of cases free of the restrictions imposed by their status as fiduciaries.

C. *The Quest for Private Advantage*

To test the limits of the fiduciary principle in limiting the pursuit of private advantage, the following Rule Against Pursuit of Private Advantage provides a useful reference point:

No partner may without the consent of all other partners secure gain, arising from his position as a partner, not shared with other partners.

The Rule, which is suggested by some of the more extreme statements in opinions concerning fiduciary responsibilities, is offered only for purposes of testing the limits of applying strict fiduciary standards to partners. As will be seen, broad application of the Rule is unworkable, and the principle it enunciates controls only certain types of abusive conduct by partners.

For purposes of assessing the efficacy of the Rule, assume *A* and *B* have formed a partnership. They bargained only on the manner in which profits would be divided and agreed on an equal division of income.¹⁵³ Since they did not establish a duration for their venture, the partnership is terminable at will.

Three scenarios follow. Each represents a pattern of conduct not unknown to partners.

1. A MISAPPROPRIATION SCENARIO

A has learned of an attractive opportunity within the scope of the partnership's business. Without telling his partner, *A* pursues the opportunity alone and diverts a number of the partnership's customers to his new business. The partnership's income drops substantially as a result of *A*'s actions.

153. This result would also have applied under the default norm. See UNIF. PARTNERSHIP ACT § 18(a). The scenario references bargaining on the issue, however, to demonstrate the importance of the profit division formula to the parties.

This presents a rather simple "misappropriation" case. *A*'s breach is clear, and *B* presumably has an incentive to seek recompense in the final partnership accounting. This example does not test the limits of the Rule Against Pursuit of Private Advantage.

2. A SQUEEZE OUT SCENARIO

The facts may now be modified to illustrate the more subtle types of misappropriations that may escape the constraints of fiduciary duties. Assume *A* correctly realizes that *B*, through no fault of her own, is not indispensable to the success of the business. *A* dissolves the partnership. Following the dissolution, the assets are liquidated and purchased by *A*.¹⁵⁴ Prior to the liquidation, *A* refrains from taking any actions designed to benefit himself at the expense of *B*. Accordingly, *B* cannot complain of *A*'s lack of candor or, with the possible exception of the squeeze out and its consequences,¹⁵⁵ compliance with fiduciary responsibilities.¹⁵⁶

One response is that *B* suffers no harm because the liquidation of the partnership's assets provides the basis for a fair settlement of her account. For good reason, *B* may disagree. What exactly is the nature of the assets being liquidated, and how is the value of those assets determined? Assets are both tangible and intangible. Tangible assets, such as chairs, typewriters, and real estate are easy to identify, although it may be questionable whether their value is realizable under distress sale circumstances.¹⁵⁷ More problematic is realizing the "going concern value" of this business. A large component of that value may lie in *A*'s continued participation in the business. So long

154. Often, asset liquidations by partnerships do not even attract outside bidders. See A. BROMBERG, *supra* note 8, § 83A. The technique of squeezing out participants is better known in the corporate setting, where dissolution is often followed by the acquisition of the assets by a corporation owned by some, but not all, of the former business partners. See generally F. O'NEAL & R. THOMPSON, *supra* note 105, § 5.21; Hornstein, *Voluntary Dissolution—A New Development in Intracorporate Abuse*, 51 YALE L.J. 64 (1942).

155. The squeeze out is more widely studied in the corporate setting. See generally F. O'NEAL & R. THOMPSON, *supra* note 105, § 5.21; Hornstein, *supra* note 154.

156. For example, *A* does not attempt prior to the dissolution and winding up to divert business from the partnership to his new venture. This is intended to distinguish the scenario from other cases in which partners have acted improperly to secure advantages in anticipation of dissolutions. See, e.g., *Leff v. Gunther*, 33 Cal. 3d 508, 516-17, 658 P.2d 740, 746, 189 Cal. Rptr. 377, 383 (1983) (an opinion containing broad language concerning post-dissolution appropriation of partnership opportunities, but adding, "From the evidence in the instant matter, the jury could well have concluded that defendants secretly began work on their independent bid *during* their participation in the joint venture . . .") (emphasis added); *Fouchek v. Janicek*, 190 Or. 251, 225 P.2d 783 (1950) (participant secretly used information obtained while a partner to preempt partnership opportunity).

157. This is particularly true when there are no outside parties bidding on the assets. See *supra* note 154.

as the partnership continues, this asset is jointly owned by the two partners. In the liquidation following dissolution, however, the value of the asset to *B* is reduced to zero, for neither *B* nor third-party bidders can capture the value of *A*'s services without his cooperation. Under these circumstances, *A*'s services are worthless to all potential parties other than *A* who need not compensate *B* to capture for his own benefit the full value of this partnership asset.

Is this a misappropriation of partnership assets, and do fiduciary standards provide a check on the use of dissolution as a squeeze out technique? Opinions are both confused and split on the issue, although for the most part they provide more support than discouragement for the dissolving partner.¹⁵⁸ In our scenario, one factor mit-

158. In *Page v. Page*, the California Supreme Court in dictum warned a partner not to attempt dissolution as a means of eliminating another partner at a bargain price:

[P]laintiff has the power to dissolve the partnership by express notice to the defendant. If, however, it is proved that plaintiff acted in bad faith and violated his fiduciary duties by attempting to appropriate to his own use the new prosperity of the partnership without adequate compensation to his co-partner, the dissolution would be wrongful and the plaintiff would be liable . . . for violation of the implied agreement not to exclude defendant wrongfully from the partnership business opportunity.

55 Cal. 2d 192, 197-98, 359 P.2d 41, 45, 10 Cal. Rptr. 643, 647 (1961). I criticized *Page* in Hillman, *supra* note 14, at 28-33.

Shawn v. England, 570 P.2d 628, 633 (Okla. Ct. App. 1977) presents a concrete application of the *Page* dictum. In *Shawn*, a partner was eliminated from the venture immediately prior to the publication of a book: "[D]efendants used the efforts and mental ability of the plaintiff for as long as they thought they needed him and then, when they got their book about ready to publish and thought they had marketing arrangements made, arbitrarily decided to eliminate his interest in joint venture assets by terminating it." *Id.* at 633. Because the partnership involved was formed for a narrow purpose and the motives of the excluding partners were so blatant, *Shawn* represents an extreme case. While a *Page*-type analysis may work well in a simple case such as this, squeeze outs for the more general purpose of eliminating a participant from a long-term venture are difficult to regulate under a "good faith" standard.

In contrast to *Page* is *Nicholes v. Hunt*, 273 Or. 255, 541 P.2d 820 (1975). In *Nicholes*, a squeeze out was accomplished without the formality of a liquidation. The court summarily rejected challenges to the fairness of the treatment of the excluded partner: "Assuming that there was [a *Page*-type] duty of good faith in this case, the evidence proves that the defendant [partner] acted in good faith and did not act in contravention of the oral partnership at will." *Id.* at 263-64, 41 P.2d at 824; *cf.* *Frank v. R.A. Dickens & Son Co.*, 264 Ark. 307, 572 S.W.2d 133 (1978) (squeeze out at book value based upon expulsion agreement upheld).

Cude v. Couch, 588 S.W.2d 554 (Tenn. 1979), is also inconsistent with *Page*. In that case, the dissolving partner owned the building occupied by the partnership, refused to lease it to anyone wishing to continue the business, purchased the assets through an undisclosed agent, and continued the business with his son. The court nevertheless concluded there had been no breach of fiduciary duties: "Unquestionably, [the dissolving partner] had an advantage, divorced from the partnership, that made it more practicable for him to carry on the business of the partnership after dissolution than for others. However, the fact that [he] benefited from that circumstance harmed neither [the other partner] nor the partnership, and breached his duty to neither." *Id.* at 556. The transaction "shocked the conscience" of the dissent: "[The dissolving partner] has appropriated to his own use and benefit the goodwill of a going busi-

igating against finding a breach is the terminable at will nature of the partnership. *B* could have bargained for a fixed term, but she did not. *B* therefore accepted from the outset that this type of development might occur.¹⁵⁹ Stated another way, *B* impliedly consented in advance to her ouster from the business. Such an inference of consent, of course, will come as a surprise to *B*, and extension of bargaining theory to this type of situation seems fanciful.

From *B*'s perspective, *A* hardly resembles a fiduciary who has acted with the "punctilio of honor most sensitive," the "utmost good faith," the "finest loyalty," or with collective rather than self-interests in mind. A quite different question, however, is whether *A* has acted rationally. The elimination of *B* from the venture seems sensible and may result in economic efficiencies the law perhaps should encourage.¹⁶⁰ But is this sufficient to satisfy *A*'s fiduciary responsibility to *B*?

For present purposes, it is sufficient to call this a close question. The mere fact that it is close, however, suggests important limitations on the scope of a partner's fiduciary responsibilities and undermines significantly the efficacy of the Rule Against Pursuit of Private Advantage. The following scenario illustrates this point.

3. A DOMINATION/REALLOCATION SCENARIO

As a rational person, *A* has a price at which he is willing to forgo

ness, for which the most elementary principles of equity and fair play demand that he pay just and reasonable compensation." *Id.* at 557 (Henry, J., dissenting).

159. It may also occur, however, in a fixed term partnership. Assume the partnership was established for a period of ten years and the term had not yet expired. *A*'s dissolution would be wrongful. He would be liable to *B* for damages, but this may prove problematic. See *supra* note 54. *B* could avoid a liquidation by continuing the business alone or with a new partner; in this case, *A*'s account settlement would not reflect his interest in the goodwill. UNIF. PARTNERSHIP ACT § 38(2). If *A* was the key actor in the business, however, the possibility of a continuation without *A* may be remote. If the business is not continued, the assets will probably be liquidated, and *A* may prove the successful bidder.

Probably more than any other aspect of partnership law, the evaluation of the free dissolvability principle as applied to fixed term partnerships requires consideration of the nature of a promise and the remedy for its breach. Is a promise a moral obligation? Or is a promise merely a commitment on the part of the promisor to pay damages in the event under the defined condition of breach of promise? Should the promisor always be given the ability to "buy out" of his duty? If so, how can this view be reconciled with the "utmost good faith and loyalty" that, at least in theory, is expected of partners?

Scholars of contract law have intensely debated the issue of whether a promise should be treated as a moral obligation. Much of this debate has occurred in recent years. The principle of free dissolvability of partnerships, however, was formulated without the benefit of more modern views on the issue. It reflects elements of both sides of the question, and firmly embraces neither. See generally Hillman, *supra* note 30, at 707-21.

160. The efficiency gain may result from awarding the assets to the partner most capable of effectively utilizing them. This point, however, would benefit from further development.

a squeeze out of *B*. Let us assume that price is a reallocation of the income distribution formula to provide *A* with an eighty percent interest in profits. This, of course, requires the consent of *B*.

Naturally, *B* would prefer to continue the venture under the original profit sharing agreement; maintenance of the status quo is in her interest, and this will be her primary concern when *A* attempts to pursue his self-interest and re-order the partnership through bargaining. This process of bargaining represents an attempt by each partner to advance self, rather than collective, interests. If the cost of re-ordering is less to *B* than the cost, including lost income, of terminating the venture, she will agree. She will not be happy, but she will nevertheless agree because continuation of the partnership is in her interest.¹⁶¹

What happened to the "trustee" and "loyalty" components of the relationship between partners? Has *A* misappropriated partnership assets?¹⁶² And how do we reconcile *A*'s pursuit of his self-interest with the principle that a partner, as a fiduciary, may not obtain any advantage over another "by the slightest misrepresentation concealment, *threat*, or *adverse pressure* of any kind"?¹⁶³

The questions are rhetorical. The Rule Against Pursuit of Private Advantage will not be applied to this type of situation; fiduciary principles never have and never will preclude all attempts at private advantage by a partner.¹⁶⁴ The threat of dissolution is indeed

161. Her alternative is to dissolve and to seek recovery for the "misappropriated" asset. This is problematic because the asset *A* seeks to capture is elusive.

162. Consider, for example, the majority and dissenting opinions in *Cude v. Couch*. See *supra* discussion in note 158. In that case, the dissolution was rather clearly for the purpose of eliminating a partner. Concluding that the objecting partner had not been harmed, the majority reasoned that the "price offered at a public sale is the best indication of an item's worth." 588 S.W.2d at 556. Ignored was the fact that, in buying the liquidated assets, the dissolving partner was effectively able to secure without payment the removed partner's portion of goodwill. This point was not lost on the dissent. *Id.* at 557 (Henry, J., dissenting).

163. *Page v. Page*, 55 Cal.2d 192, 195, 359 P.2d 41, 44, 10 Cal. Rptr. 643, 646 (1961) (quoting and reaffirming the principle stated in pre-U.P.A. opinions).

164. Consider *Rosenfeld, Meyer & Susman v. Cohen*, 146 Cal. App. 3d 200, 194 Cal. Rptr. 180 (1983). In *Rosenfeld*, two partners in a law firm dissolved the partnership and established their own firm. Prior to the dissolution, the firm, through the two partners, had rendered substantial pre-trial services for a client, incurring significant expenses in the process. As the trial date approached, and as attention was focused on a potentially huge settlement, the two partners demanded a reallocation in their favor of partnership income. They threatened to withdraw from the firm if the reallocation was not made, although it was unclear whether any adjustment in income would have satisfied these individuals. The reallocation was not made, and the partners withdrew from the firm, taking the client with them. This presents a rather simple "misappropriation" case, and the court correctly concluded that fiduciary responsibilities would preclude partners from dissolving the firm in order to capture for themselves fees for the work done largely during the partnership's life. Necessarily, a threat to misappropriate assets in an attempt to reallocate partnership income is also culpable

“adverse pressure,” but it is the type of pressure that necessarily prompts bargaining and re-ordering within partnerships. Rather than attempting to force partners to conform to a standard that is neither realistic nor desirable, emphasis should be placed on developing predictable and systematic standards to define *unacceptable* pursuit of private advantage within partnerships. Existing standards are impossible to define, arbitrary in application, ineffective in the achievement of their stated goals, and premature in their canonization of participants in partnerships.

V. CONCLUSION

Much of partnership law remains unexplored, and the sacred cow status of the field is paradoxical. Widespread generalizations on such matters as the nature of a partnership agreement, the timing of bargaining that takes place between partners, the role and efficacy of statutory norms, the status of partners as fiduciaries, and limitations inherent in the use of law to control the pursuit of advantage within partnerships should be reevaluated. In light of the decision of the National Conference of Commissioners on Uniform State Laws to revise the U.P.A., the time has come for the development of a broad base of commentary on the important but neglected subject of partnership law.

conduct. The case thus differs from our scenario, where the threatened squeeze out is not for the purpose of misappropriating the value of unfinished business; the asset pursued by *A* is but a vague expectancy of future prosperity. However comforting the notion of applying fiduciary principles to this type of situation, such a result would mark a radical departure from the far more limited application of these principles to date.